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FACILITATING FASTER PAYMENTS IN THE UNITED STATES

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED SIXTEENTH CONGRESS

FIRST SESSION

ON

EXAMINING THE CURRENT STATE AND EVOLUTION OF THE U.S. PAYMENTS ECOSYSTEM AND HOW THE CURRENT PAYMENTS SYSTEM WORKS OR COULD BE IMPROVED

SEPTEMBER 25, 2019

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C O N T E N T S

WEDNESDAY, SEPTEMBER 25, 2019

FACILITATING FASTER PAYMENTS IN THE UNITED STATES

WEDNESDAY, SEPTEMBER 25, 2019

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 10 a.m., in room SD–538, Dirksen Senate Office Building, Hon. Mike Crapo, Chairman of the Committee, presiding.

OPENING STATEMENT OF CHAIRMAN MIKE CRAPO

Chairman CRAPO. The Committee will come to order.

Today the Committee will turn its focus to facilitating faster payments in the United States. Faster payments are important and yield economic benefits for both consumers and businesses by providing them with greater flexibility when managing money and making time-sensitive payments on demand.

Real-time payments offer efficiency and convenience, helping consumers to better manage their spending and avoid unnecessary fees and penalties, and helping businesses pay for goods and avoid other costly sources of funding.

Unfortunately, the U.S. has lagged behind other countries in the development of real-time faster payments for retail.

Recognizing this shortcoming, in 2015, the Federal Reserve organized a Faster Payments Task Force, made up of a diverse group of stakeholders, to encourage the development of a real-time payment system in the United States.

The Fed stated in its report on strategies for improving the U.S. payment system that it "would not consider expanding its service provider role unless it determines that doing so is necessary to bring about significant improvements to the payment system and that actions of the private sector alone will likely not achieve the desired outcomes for speed, efficiency, and safety in a timely manner."

Responding to the mission of the Faster Payments Task Force, The Clearing House announced in 2016 its intent to launch a real-time payments system, which it officially launched in November 2017.

Just prior to The Clearing House launching that system, the Faster Payments Task Force in July of 2017 issued a final report, which offered several recommendations for achieving a safe, ubiquitous, and efficient faster payments system in the United States.

One of those recommendations was for the Federal Reserve to develop its own 24x7x365 real-time gross settlement system for retail payments and to assess whether there were other operational roles the Fed should play in faster payments.

After determining the Federal Reserve Banks should develop a new real-time gross settlement service, on August 2, 2019, the Federal Reserve Board voted on the Fed's proposal. The lone dissenter was Vice Chairman for Supervision Randy Quarles.

The Federal Reserve then issued a notice and request for comment on Federal Reserve Actions to Support Interbank Settlement of Faster Payments—a system referred to as FedNow.

In Vice Chairman Quarles' dissent, he noted that, "The U.S. private sector has a long history of providing efficient payment solutions to consumers and businesses." He added that, "The public sector should provide its own capacity only when the evidence of market failure is clear and alternative means to achieve public goals are not feasible. He added that he "does not see a strong justification for the Federal Reserve to move into this area and crowd out innovation when viable private sector alternatives are available."

Additionally, when providing a new payment service, the Federal Reserve is required to meet certain obligations and criteria before moving forward. Those criteria are: the Federal Reserve must expect that its providing the service will yield a clear public benefit; the service should be one that other providers alone cannot be expected to provide with reasonable effectiveness, scope, and equity; and the Federal Reserve must expect to achieve full recovery of costs over the long run.

Throughout the Fed's process, some financial institutions have raised concerns about the Fed's analysis and its process, the cost and amount of time it would take to develop its own real-time payment system, its prospects for achieving interoperability, inherent conflicts of the Fed operating its own system, and prospects for negatively affecting existing real-time payment systems.

Still, other financial institutions urged the Fed to move forward due to their concerns surrounding pricing, power, and competition in the marketplace.

I strongly support better, safer, and faster payments in the U.S., including the work already done on existing solutions in the private market.

I look forward to learning more about numerous issues during this hearing, including: clear demonstration of the market failure or problem that the Fed believes it must solve through the development of its own real-time payments system; how the existing real-time payments platform works, how it has been impacted by the Fed so far, and the consequences of the Fed developing a competing system; and how the Fed believes its proposed system could achieve interoperability, minimize negative effects to existing private sector participants, and fully recover its costs quickly.

I look forward to hearing from each of you on your views on these payments in the U.S. and more about the existing and proposed platforms.

Senator Brown.

OPENING STATEMENT OF SENATOR SHERROD BROWN

Senator BROWN. Thanks, Mr. Chairman. Thank you to the very distinguished panel with us today.

Whether it is Facebook thinking it can run its own currency or big banks wanting a monopoly over our payment system, we cannot allow corporations to take over critical public infrastructure so they can squeeze more profits out of working families.

Whether you punch a clock or swipe a badge, every working American knows how important payday is. It is often the day you know you can pay your bills and make rent. But sometimes payday does not line up with the day your bills are due. If that means a delay in paying the bills, banks will pile on late fees and overdraft charges, so it is even harder for people to make ends meet.

Recently, the Federal Reserve Board announced that it will develop a system to provide payments in real time. This is great news for millions of Americans who live paycheck to paycheck—for anyone who has waited for a check to clear or had to resort to a payday lender on Friday to tide them over until Monday. Faster payments will allow Americans to actually use more of the money they have already earned.

But while some of us see a problem to solve for working families, the biggest Wall Street and foreign banks see opportunity. They see what they always do, and that is dollar signs. They see another way to squeeze more profits out of the rest of us.

That is why they do not want the Fed to be involved. They built their own real-time payment system on top of existing Federal Reserve infrastructure, but we really do not know how it is governed, how much it will cost, or how they plan to skim more profits off the top.

We cannot trust that the big banks will not charge more to community banks and credit unions. They have already changed their mind on their prices once, and there is no guarantee they will not change their minds again.

Big banks oppose the Fed's efforts because they want to be the only game in town.

We know what happens when we trust Wall Street.

Eleven years ago this month, Lehman Brothers failed, sparking the worst financial crisis since the Great Depression. Many of the big banks now asking for this monopoly over the real-time payments system are the same Wall Street banks that wrecked our financial system and came begging for billions of dollars in taxpayer money to save them.

They have not exactly cleaned up their act.

These same banks, like Wells Fargo, Bank of America, and the President's favorite, Deutsche Bank, have been involved in scandal after scandal, creating fake accounts for customers, illegally foreclosing on servicemembers' homes, violating U.S. sanctions laws—on and on and on. It seems like there is a new scandal every day. Capital One just suffered a huge data breach, exposing millions of customers' personal data.

Remember those overdraft fees and late fees and transfer fees that we are trying to protect workers from? It is these same big banks that slap on those fees. They created this problem; now they want to charge people to solve it.

To make matters worse, the Administration is rolling back the safeguards that we put in place to protect working families from the risky Wall Street activities that crashed our economy.

It was another financial crisis over 100 years ago that led us to create the Federal Reserve to clear payments and govern our currency. Congress recognized the high fees and abuses going on in our payment system and understood that we needed a publicly run—a publicly run—central bank to provide financial stability and fair access to the payment system. In the words of Representative Glass—later to be the Senator Glass of Glass–Steagall—they "sought to tear down these tollgates upon the highways of commerce."

That is how we should think about the payment system—as the highways of commerce that support every dollar that fuels our economy. Just like roads and bridges, the payment system is critical public infrastructure, something that everyone—everyone—should be able to use. We cannot let profit-motivated big banks—banks whose mission is to serve shareholders, not ordinary Americans—we cannot let them have a monopoly over it.

This Committee has heard a lot this year about big corporations taking advantage of us through the smoke screen of new technology and innovation.

In our data privacy hearings, we heard about big tech companies and financial firms manipulating us into sharing our personal data so they can profit.

At our hearing, Facebook dodged our questions about its plan to run its own digital currency out of a Swiss bank account—showing yet again that we cannot trust them.

We cannot allow big corporations to take over critical public infrastructure. You would think we should know that by now. The largest banks and tech companies are not acting in the interest of working Americans. Their interest is to turn a profit for themselves and their investors. I understand that.

But the Fed's interest is not to make a profit. It is to make sure everyone, that all people can pay their bills on time and transfer money when they need it, whether they live in rural America or in a metro area.

The Fed's real-time payment system will benefit working families, small banks and credit unions, small businesses, and the public as a whole. Everyone except Wall Street agrees.

Thank you, Mr. Chairman.

Chairman CRAPO. Thank you, Senator Brown.

Today's witnesses are: Ms. Esther George, president and chief executive officer of the Federal Reserve Bank of Kansas; Mr. Robert Hunter, executive managing director and deputy general counsel of The Clearing House; Mr. Bob Steen, president and chief executive officer of Bridge Community Bank, on behalf of the Independent Community Bankers of America; Mr. George Selgin, senior fellow and director of the Cato Institute; and the Honorable Sheila Bair, former Chair of the Federal Deposit Insurance Corporation.

Again, I want to thank all of our witnesses for being here and sharing with us your expertise today. Your written testimony has been entered into the record. We will take your testimony in the order I introduced you, and you may start, Ms. George.

STATEMENT OF ESTHER GEORGE, PRESIDENT, FEDERAL RESERVE BANK OF KANSAS CITY, ON BEHALF OF THE FEDERAL RESERVE SYSTEM

Ms. GEORGE. Chairman Crapo, Ranking Member Brown, and Members of the Committee, thank you for this opportunity.

Chair Powell has asked me to speak to you today in my role as the Federal Reserve Bank leader responsible for our payments improvement initiative since its beginning and as Chair of the Financial Services Policy Committee, which oversees the provision of payment services to depository institutions and the United States Treasury by the 12 Federal Reserve Banks. I am pleased to offer my statement for the record as well as an in-depth statement on the role of the Federal Reserve in the payments system and the recently announced proposal to support faster payments through the development of a new service called "the FedNow Service."

Since the Federal Reserve's founding more than a century ago, it has provided payment and settlement services as part of its core function of promoting an accessible, safe, and efficient payment system. Today the Federal Reserve is continuing this important operational role and preparing to support the modernization of our Nation's payment system with capabilities that allow payments to move quickly through a safe and efficient foundation, on top of which innovation and competition can flourish.

This decision was made only after three established criteria were met.

The first of these criteria is that other providers alone cannot be expected to provide the service with reasonable effectiveness, scope, and equity.

Of notable importance related to this criterion is the Federal Reserve's ability to connect to more than 10,000 financial institutions. Through these connections, our existing payment services allow banks of every size to serve the needs of thousands of communities across the United States with competitive, fair, and transparent access. Providing comprehensive nationwide reach is something that we believe will present significant challenges to other providers in the current market landscape. Coming from a region of the country with a significant number of small community banks serving rural areas of the central United States, I can tell you the Board's decision to provide this new service has been very well received.

The second criterion is that there will be a clear public benefit, including promoting the integrity of the payments system and reducing payments system risk.

The Federal Reserve must continue to play an important role in promoting the safety of the U.S. payment system by providing liquidity and operational continuity in response to financial turmoil, terrorist attacks, natural disasters, and other crises. The FedNow Service will allow the Federal Reserve to retain its ability to provide stability and support to the banking system, as well as promote the development and implementation of industrywide fraud mitigation standards. Development of the service will also enhance safety of the U.S. payment system by promoting resiliency through redundancy.

The third and final criterion is that the Fed be able to fully recover its cost over the long run. The U.S. payments infrastructure today includes alternative payment choices and providers. The Federal Reserve and The Clearing House currently operate competing and interoperable services, which bring important benefits for resiliency and competition. In all of our services, we have been able to meet the requirements of the Monetary Control Act for cost recovery that ensures competitive fairness while fulfilling our public policy goals. We fully expect this will be the case with the FedNow Service.

As was explained in a 2016 GAO study, the Federal Reserve's role as an operator has long been judged as effective in promoting accessibility, safety, and efficiency for the Nation's payment system and its customers.

Last summer, the U.S. Treasury recommended that "the Federal Reserve move quickly to facilitate a faster retail payments system." We are engaging now with stakeholders for their input on features of the FedNow Service through the *Federal Register* notice issued last month, and I am confident that together we can achieve our public policy objectives for broadly accessible, safe, and efficient faster payments.

Thank you. I am happy to respond to your questions.

Chairman CRAPO. Thank you.

Mr. Hunter.

STATEMENT OF ROBERT HUNTER, EXECUTIVE MANAGING DIRECTOR AND DEPUTY GENERAL COUNSEL, THE CLEARING HOUSE PAYMENTS COMPANY

Mr. HUNTER. Chairman Crapo, Ranking Member Brown, and distinguished Members of the Committee, my name is Rob Hunter, and I am the deputy general counsel of The Clearing House, based in our North Carolina facility. I have worked at The Clearing House for more than 10 years providing senior legal support to our payments systems, including our focus today, the RTP network, which I was privileged to be involved in developing. I am also the past Chair of the Subcommittee on Electronic Payments of the American Bar Association and have been involved in payments throughout my career.

The RTP network is a new and exciting part of our national payment infrastructure. It was launched in 2017 by The Clearing House, is fully operational, and today reaches over 50 percent of the transaction accounts in the U.S. One of the most distinguishing features of the RTP network is that it operates in real time and all the time. There are no "bankers' hours." It functions 24x7. The RTP network also delivers on the vision of faster, more efficient, and more secure payments that will benefit every American consumer and business.

This innovation is consistent with The Clearing House's long history of providing core payments infrastructure that is efficient, safe, and reliable. Founded in 1853, for over a century-and-a-half The Clearing House has served as the leading private sector operator of payments infrastructure in the United States. On an average business day, The Clearing House clears and settles nearly $2 trillion over its wire transfer, automated clearing house, and check-clearing networks.

Created to provide the payment services required by the Nation's economy, The Clearing House exists to serve depository institutions of all sizes. In fact, more than 80 percent of the participants in our ACH and check-clearing services are institutions under $10 billion in assets.

The Clearing House prices its services on a cost recovery basis, and there is no special pricing for owner banks. The Clearing House also has a remarkable history of operational resiliency, clearing and settling payments every day without fail, through world wars, financial crises, and natural and manmade disasters, including 9/11 and the Great Recession.

This morning, I would like to briefly focus on the Committee's request that I describe the RTP network and in doing so will focus on the Fed's Faster Payments Task Force as well as touch on FedNow. My written comments expand on these topics as well as other questions posed in your invitation letter.

The payments landscape in the United States is highly competitive. Although there has been tremendous innovation in end-user products during the last decade, what has been lacking is modernization of what we often refer to as "the payments rails that undergird the system." The Federal Reserve recognized the need for faster payments, used its convening power to urge the private sector to make real-time payments a reality, and established a Faster Payments Task Force. Not only did the industry respond by designing, building, and bringing to market the RTP network, investing over $1 billion to do so, but according to the ratings it received from the task force, it did so extremely well.

Of the 16 different private sector proposals submitted to the task force, the RTP network was rated the highest, including in such key areas as accessibility and path to ubiquity or nationwide reach.

As I speak to you today, the RTP network is operating, delivering the real-time capabilities that Americans want and need. Payment recipients receive final good funds immediately, and payment senders receive real-time confirmation that the funds have been received. The benefits to consumers, small businesses, and the Nation's economy are transformational.

The Committee has requested our views on the Fed's decision to enter the real-time payments market. As provided in my written testimony, The Clearing House is concerned that the Fed's actions may hinder The Clearing House in achieving the full potential of the RTP network. When the Fed competes with the private sector, it must do so in a manner that minimizes the competitive advantages that a Government system would have, both inherently and as a direct byproduct of the Fed's role as supervisor, the supplier of liquidity to the financial system, and the central bank.

This is not the usual competitive question of impact on profitability because The Clearing House does not seek to operate at a profit. Rather, it is a question of The Clearing House's ability to provide the most effective and efficient real-time payment system to consumers and businesses to the ultimate benefit of the overall economy.

To help The Clearing House achieve this objective, we believe there are several actions that the Fed could take now before launching its FedNow Service that would help to create competitive equality between the private sector and the Government. These are detailed in my written statement.

In conclusion, The Clearing House RTP network is the most advanced payment system in the world, and we are working hard to extend its benefits to banks and credit unions of all sizes so consumers and businesses across America can realize the benefits of faster, more efficient, and more secure real-time payments.

We appreciate your interest in this topic, and I look forward to answering your questions.

Chairman CRAPO. Thank you.

Mr. Steen.

STATEMENT OF ROBERT A. STEEN, CHAIRMAN AND CEO, BRIDGE COMMUNITY BANK, ON BEHALF OF THE INDEPENDENT COMMUNITY BANKERS OF AMERICA

Mr. STEEN. Chairman Crapo, Ranking Member Brown, and Members of the Committee, I am Bob Steen, chairman and CEO of Bridge Community Bank in Mount Vernon, Iowa.

I testify today on behalf of the Independent Community Bankers of America, where I have played an active role over the years, including serving on the Payment Committee. Thank you for the opportunity to testify today.

I believe it is imperative that the U.S. develop a robust real-time payments system to meet consumer and business demand and stay competitive with the rest of the world. This system must create access for customers of all financial institutions, regardless of size, in every American community.

How we achieve this goal is critical. A real-time payments system is too important to be entrusted to a private monopoly. The two dozen largest banks simply cannot own and operate the U.S. payments system. ICBA strongly supports the Federal Reserve's decision to build FedNow, a real-time payments system that will give direct access to all financial institutions and their customers.

Bridge Community Bank is a $96 million community bank founded in 1903 and is owned by our 20 employees. We serve rural communities in growth markets in and around Cedar Rapids and Iowa City with small business, agricultural, and consumer banking. Our business model is relationship banking in which we serve the totality of a family's business and personal banking needs, both deposits and lending. The transaction account is the key to the customer relationship, and it is at the heart of community banking. We have long recognized that payment innovation is critical to the long-term prosperity and independence of our bank and community banking. This is why I have invested so much of my career in payment innovation and developed multiple payment projects in our small bank.

Only the Fed can guarantee competition and choice. The U.S. does not need another closed-loop payment system in which some financial institutions participate and others are excluded. All financial institutions and all customers must have access to real-time payments, even those that live in small and rural communities exclusively served by community banks. I firmly believe this simply cannot happen without the Fed's role in real-time settlement.

The Fed is uniquely positioned to provide access to all 11,000 financial institutions because these institutions have access to a settlement account and a service connection with the Fed. The Fed already operates a universally accessible check, ACH, and wire transfer service.

If history is any guide, the Fed will maintain affordable as well as universal access to faster payments. The Fed offers a fair and affordable pricing structure today, even to the smallest of the small financial institutions like our small bank.

The Fed is trusted among community banks. Each community bank has a relationship manager and the opportunity for direct access to the payment system. I know our representative's name, I know his cell number, and he answers the phone. As a community bank, I know that I have direct and easy access to Fed support services even after our banking hours, and I place a high value on that access.

As I stated at the outset, payments innovation, offering customers what they want when they want it, is critical to the prosperity and continued independence of our community banks. As a neutral real-time settlement network, FedNow will be critical in our ability to continue to innovate. For example, my bank, in partnership with another community banks, developed a mobile app called "ExcheQ" which allows a user to send money to anyone in the U.S. that has an account at any other financial institution without a payment application on the receiver's mobile device. Once FedNow is fully operational, ExcheQ will allow real-time transactions without being dependent on our core banking. That by itself is transformational. Once ubiquity is achieved through FedNow, new use cases and opportunities for innovation will emerge.

The Fed's entry into real-time payments is part of a natural evolution from its involvement in check clearing, ACH payments, and wire transfers. The Fed has strengthened the payment system by providing safety, integrity, choice, and equitable access to all financial institutions. I am confident the Fed will bring the same critical benefits to real-time payments.

Thank you again for convening the hearing, and I will try to answer any questions.

Chairman CRAPO. Thank you.

Mr. Selgin.

STATEMENT OF GEORGE SELGIN, SENIOR FELLOW AND DIRECTOR, CENTER FOR MONETARY AND FINANCIAL ALTERNATIVES, CATO INSTITUTE

Mr. SELGIN. Thank you, Chairman Crapo, Ranking Member Brown, and distinguished Committee Members. I am the director of Cato's Center for Monetary and Financial Alternatives, but before I came to Cato, I was for 30 years an academic economist specializing in monetary and payments theory and history.

The slow pace of payments in this country is a disgrace that is taking a large toll on U.S. citizens and particularly on those who live paycheck to paycheck, so I very much appreciate this opportunity to address you and offer suggestions for helping to speed payments up in this country. I particularly want to discuss steps that Congress might take to assure that outcome.

The Fed claims that the best way to solve the problem of expediting payments is for it to compete directly with existing retail payments networks and RTP, The Clearing House fast payments system, by establishing its own fast payments system, FedNow. And competition from the Fed certainly could help to promote faster payments, but it only will do so if the Fed competes on an even or level playing field with existing private sector service providers. However, the Fed enjoys many very special privileges that can allow it to slant the playing field in its favor, and when it does that, the outcome can be not to facilitate the achievement of faster payments but to hinder its achievement.

I want to talk about several ways in which the Fed can slant the playing field in its favor that can harm progress toward faster payments. One of them is by failing to offer 24/7/365 interbank settlement services. You have heard before and you heard from Senator Brown how many persons live paycheck to paycheck, and when their checks do not clear quickly or their payments do not clear quickly, then they wait days in order for funds to be made available to them, and many resort to payday lenders for that reason.

Real-time payments can, of course, help solve that problem, but, actually, they are not necessary. Those workers would benefit just from having payments available on the same day, that is, having funds released on the same day. The problem they face is not that their funds are not released instantly. It is that they take several days sometimes to be released.

Now, why is that? It is not because we do not have a real-time payments system. It is because the Fed's own net settlement services, Fedwire and the National Settlement Service, do not operate on weekends, and do not operate on holidays.

Now, the Fed has known about this problem and has talked about fixing it for years, and NACHA has encouraged it to do so, but it has been dragging its feet. And that means that it is making it harder for existing payment systems to compete effectively with it. I ask Congress to take the crucial step of making sure that the Fed fixes this problem.

By the way, when it decided to launch FedNow, it amazingly decided not to proceed with 24/7 settlement services on its existing networks, and there is no excuse for that because support for that reform is unanimous.

A second point—in my written testimony, I talk about four—concerns the pricing of settlement of faster payment services. You have all been told that the Fed needs to compete because it is worried that The Clearing House will abuse its monopoly, but, in fact, the facts are otherwise. The Clearing House, as it said—and I know this from studying its history—does not charge in order to make profits. It is providing a service to its members through the payment facilities it administers for them. It does not pay dividends, and this has been true throughout its history. It is verifiable.

The problem is that the Fed can charge volume discounts, and the TCH is planning to charge flat fees. Now, why does the TCH want to allow itself to go to volume discounts if it needs to? It is because in competing with the Fed in ACH services, it found the Fed resorted to steep volume fees in the 1990s, and it had to follow suit. The only reason it has a loophole in its pricing policy is that the Fed might resort to volume payments itself. Congress can prevent the Fed from doing that by making it make the same commitment to flat fees that are equitable to small banks as The Clearing House has made.

I will stop there. There is more in my testimony along the same lines. Thank you.

Chairman CRAPO. Thank you.

Ms. Bair.

STATEMENT OF SHEILA C. BAIR, FORMER CHAIR, FEDERAL DEPOSIT INSURANCE CORPORATION

Ms. BAIR. Mr. Chairman, Members of the Committee, thank you so much. It has been a while since I have been before this Committee. It is nice to be back.

I am here in a personal capacity as someone who has spent most of my career in financial services, most of that time as a regulator, and as you know, who had led the FDIC during the financial crisis. And I saw firsthand how concentrations of financial power in a handful of so-called too-big-to-fail institutions almost ran our economy into a ditch and forced trillions of dollars in Government support.

To be sure, megabanks are safer now, but I do not think they are safe enough, and postcrisis reforms have been untested so far. We do not know how well they are going to work, and even now they are subject to unrelenting challenge by industry groups, including, I might add, TCH.

The sector remains heavily concentrated. Over half of deposits are in the largest 15 institutions. Nearly half of all assets are concentrated in the top five. Given the continued dominance of megabanks in our financial system, do we also really want to cede to them control of the infrastructure supporting the next generation of payment services?

You will be hearing competing arguments today about whether FedNow will promote or hinder competition, whether it will foster or inhibit innovation to meet demand for real-time payments, whether it will broaden access and equitable pricing or result in additional unnecessary costs. In evaluating these arguments, I hope we can all apply some basic common sense. Which kind of payment infrastructure is more likely to promote competition—a single system controlled by an entity that is owned by already dominant for-profit banks, or one that is supported by two parallel systems, one of which is operated by a Government agency whose mandate is to ensure equity and fairness in the provision of payment services?

Which payments infrastructure will better promote innovation—one dominated by a single monopoly or one resting on two systems from which financial institutions and their FinTech partners can choose in offering their customer-facing platforms and services?

Which payments infrastructure is most likely to promote resiliency—one solely built on the stability and operational integrity of large banks, behemoths which still operate with high levels of leverage and have failed in the past in times of stress, or one that can also rely on a system operated by a Government entity like the

Fed with a proven track record of success in managing through the most distressed of economic conditions?

And, finally, which payments infrastructure is most likely to achieve ubiquity in reach and access among all depository institutions, regardless of size or geographic location—one run by an organization whose owners are heavily located in east coast urban areas, or one which includes a second system, like the Fed, that has preexisting trust relationships with virtually every depository institution in the country?

Some have tried to portray the Fed as a bureaucratic heavy, interfering with private sector innovations to provide real-time payments, motivated not by public interest but self-interest and preserving their power in the payment system. I frankly think that is nonsense. The truth is that the Fed had taken a measured, deliberative approach to whether they should build their own real-time interbank settlement system. They have waited for the private sector. They have let the private sector try to innovate to meet market demand for faster payments, and indeed, the U.S. has fallen behind.

So while I congratulate TCH on developing the RTP system, the truth is it has not gained significant traction, and the overwhelming majority of public commenters who the Fed solicited said the Fed should build its own system. The Fed has worked hard to support TCH's efforts. It is not that the TCH RTP system is going to go away. And they are committed to use a process in building FedNow that will incorporate the views of TCH and others and hopefully eventually achieve interoperability. But, again, the Fed has determined based on a consensus that pretty much include everyone other than the big banks that their operational participation is required to ensure a next-generation payment system that is ubiquitous, fair, inclusive, and resilient.

We saw in 2008 what happens when a handful of very large institutions are allowed to dominate basic financial infrastructure, and I for one never again want to see a gun placed against the head of taxpayers—bail the banks out or watch your economy go down. 2008 was bad enough. I shudder to think if those same banks had sole control of our payment system of the future. When it comes to payments infrastructure, two is definitely better than one. I think the Fed is right to step in, and I hope that the Congress will support them.

Thank you.

Chairman CRAPO. Thank you.

I am going to focus my questions on Ms. George and Mr. Hunter and just ask you each to respond to the concerns that have been raised by those who are worried about your particular approach. For example, Ms. George, first, what do you say to those who say that the Fed has an unfair advantage and would actually operate from an unbalanced playing field in a way that would reduce the effectiveness of both payment systems?

Ms. GEORGE. I would point to the Federal Reserve's history in operating payment services across a variety of rails. There has been no instance when the Federal Reserve has not operated alongside with the private sector and we have been very transparent in meeting the requirements that we offer competitive and transparent pricing on our transactions.

That history was confirmed with the GAO report which looked at this very issue of what the Fed's role has been, what has happened to innovation in the economy and consumer prices related to those payment services, and concluded that the Fed's role has been beneficial in operating in that space. So the history would support our intent, even with this new FedNow service, to continue in that tradition.

Chairman CRAPO. All right. Thank you.

Mr. Hunter, what do you say to those who indicate that they do not understand why there would be a concern about having a competitive alternative in the payment system?

Mr. HUNTER. Thank you, Mr. Chairman. We are not against competition in the payment system, but if there is going to be competition in the payment system between us and the Fed, we want to make sure that that is a level playing field between the private sector and the Government.

There are two particular issues that the Fed could address to ensure that there is a level playing field between the private sector and the Government. One was briefly touched upon by Mr. Selgin. The Fed has architected FedNow, what little we know about it, to effectuate settlement through master accounts at the Federal Reserve, which only the Fed can offer. Those accounts count toward reserve balances and they bear interest. The Fed could accord this same treatment to the RTP account that we use for settlement that is sitting at the Federal Reserve Bank of New York. So that is one issue.

The other issue deals with the potential liquidity that is needed by the system on nights and weekends. The Federal Reserve has indicated that it is architecting its system so that the system itself will not enforce net debit caps on nights and weekends when the Federal Reserve—Fedwire Service is not available and NSS is not available. That can put banks in credit positions. It is an architecture that, frankly, the Federal Reserve under the requirements that we have for establishing the account is not available to us. We wouldn't probably do it anyway because we consider it unsafe and unsound for banks to get into large credit positions or potentially large credit positions during times when Fedwire and NSS are not available.

As Mr. Selgin noted, the one recommendation that came out of the Faster Payments Task Force that was unequivocal and upon which everyone agreed in the comment letter process was for the Fed to extend the operating hours for Fedwire and NSS. It is the single most important thing that the Fed can do to encourage private sector competition, and we would urge the Fed to do that.

In addition to that, we are committed to level pricing for banks of all sizes. We have made that commitment publicly. We understand the history of the ACH where we had a level pricing structure, but the Fed came in and offered steep volume discounts in order to try to lure banks away from The Clearing House's ACH service. That is the source of the caveat that we have made, and we wanted to be transparent with the market and indicate that we are committed to a level pricing structure. Whether you are the

JPMorgan Chase or you are the little bank of Oak Ridge, North Carolina, where I live, you will pay exactly the same. But I think we need a commitment from the Federal Reserve to engage in that same level pricing structure so that community banks and banks of all sizes can pay the same amount regardless of the service.

Chairman CRAPO. All right. Thank you.

Senator Brown.

Senator BROWN. Thanks, Mr. Chairman.

Mr. Hunter, thank you for those last comments. Your website says The Clearing House is owned by 25 of the world's largest commercial banks. As we all know, painfully, 10 years ago a lot of those banks needed to be rescued by taxpayers. Do you know how much taxpayer money your member banks needed to stay afloat?

Mr. HUNTER. I do not, Ranking Member Brown, but I will tell you one sector of the economy that functioned flawlessly throughout the——

Senator BROWN. I know what——

Mr. HUNTER. ——clearing and settlement——

Senator BROWN. The answer to my question is $194 billion, and to think that you then want a monopoly on the payment system just does not seem wise.

President George, let me start with you. Thanks for your work on this question. Does part of the Fed's proposal specifically benefit The Clearing House's real-time payment system?

Ms. GEORGE. At the start of our work on looking at faster payments, we were very interested in making sure the private sector was able to participate in this effort and created a special account that would allow for them to operate their real-time payment system.

Senator BROWN. So, logically, then it is fair to say The Clearing House wants the Fed to support real-time payments but only in a way that helps their private payment systems owned by the big banks?

Ms. GEORGE. We have worked alongside The Clearing House in many payment services, and it would be unusual for us not to work alongside them even in this new rail.

Senator BROWN. OK. Ms. Bair, sorry I missed the beginning of your statement. I heard people describe it behind me. I am in and out of—I apologize. I do not usually do this, but we are doing Agent Orange and burn pit, and it is a hearing that I asked Chairman Isakson to hold, and so I need to return. I apologize.

As FDIC Chair during the crisis, you saw firsthand the big bank failures and the havoc they wreaked on our financial system and economy. How does the concentration of critical public infrastructure—and that is what this is—in the hands of the biggest banks pose a risk to our economy? What would happen to small banks, and what would happen to working families during a crisis if large banks controlled the payment system?

Ms. BAIR. Well, I think, first of all, I would like to say that if you count all Government support, including FDIC debt guarantees and Fed lending, we are well into the trillions. The taxpayer number was what you cited, but it was quite a massive——

Senator BROWN. Being conservative.

Ms. BAIR. Yes, you are being very conservative. Look, I think you have centralization of risk. You have a single point of failure. We have operational risk with just having one system. You also have—the system is backed by a joint account which is funded by these large banks, so if one or more of the large banks could no longer fund into the joint account, we do not know what will happen.

I think eventually if there is a disruption to—if we have this monopoly payments provider and there is a disruption, the Fed is going to have to come in anyway, and it will probably be a lot more difficult and costly and potentially disruptive if they have to take two or three steps to come in to support and bail out the monopoly system that the large banks are running. So we need two systems. Nobody is saying that we should not have RTP. That is fine. But we need two systems, and it is much more than protecting, the public coffers. There are the equity issues in terms of the Fed's willingness to work with all parties and be accessible and priced fairly with all parties. That is also a significant policy benefit of having two systems.

Senator BROWN. Thank you.

Mr. Steen, thanks for being here. I admire that you run an employee-owned bank where workers have a stake in the company. Thank you for that.

With increasing consolidation in the industry and the growing number of nonbanks and FinTechs engaged in traditional banking, it seems to be harder—getting harder for community banks to compete. Why is the Fed's decision to operate a faster payment system so critical for community banks like yours, employee-owned, but obviously other community banks as part of the ICBA?

Mr. STEEN. Well, Senator, thank you. As I indicated in my statement, we believe that transaction accounts are the basic core relationship with our customers, and we believe we have to provide them the technology and the faster payment that they need. Many of our customers do need money sooner than they are getting it today. We provide availability early, as early as we possibly can. On Thursday night at midnight, they get their Friday pay. We do everything we can do to get them the money. But we can make it better, and we believe FedNow will do that.

Senator BROWN. Thank you to all of you.

Chairman CRAPO. Thank you.

Senator Moran.

Senator MORAN. Mr. Chairman, thank you. Thank you for hosting this hearing, you and the Ranking Member. When you introduced Ms. George, you introduced her as the president and CEO of the Federal Reserve Bank of Kansas, and I appreciate your thriftiness in choice of words.

[Laughter.]

Senator MORAN. I also would like to pay tribute to Ms. Bair, a highly respected Kansan, a native, and who is highly regarded. She had the benefit of working for a highly regarded Senator, and I appreciate your work throughout your life.

Let me start with Ms. George. Generally, I would say in Kansas this proposal is popular with Kansas bankers. Interoperability is important in addition to prompt payment, and I want to see if you can assure me that whether a bank chooses FedNow or the RTP system to provide those faster payments, their business will flow to any institution in either network. Today both institutions run retail and wholesale payment services that are inoperable. Is the Fed committed and confident that it will be able to continue the same with these faster payments?

Ms. GEORGE. Senator Moran, having interoperability will be a desirable outcome of this effort. We are focused on gaining nationwide reach. We think it is important that every financial institution gain access to real-time payment services, and then we can begin, as we design the system, to look at what the nature of interoperability will be. We are now asking for comments on features and design, including interoperability, and getting feedback on how that would work today relative to how it works with our other payment services.

Senator MORAN. Mr. Hunter, how do you see this issue?

Mr. HUNTER. Thank you, Senator. I appreciate the question. We do not envision that the systems will be interoperable. Real-time payments are fundamentally different in terms of how they work than the ACH or the wire transfer system, and if you look at Europe, for example, where the central bank came out with its own real-time payment system, it is not interoperable with TIPS, which is the private sector's real-time payment system. In a real-time payment system, clearing, which is the transmission of the payment message, happens alongside settlement. They are not bifurcated at all. They happen at the same time, and they happen instantaneously. So from the time I hit "Send" to send you money, Senator Moran, to the time that money is in your account and you have got access to it, it is literally milliseconds. Because of that architecture, which is architected in the way that the Federal Reserve's Faster Payments Task Force sort of set out the criteria, it wanted a real-time payment system, you cannot bifurcate those processes. So it is not like the ACH, which is interoperable for transmission of the message only, but settlement happens at a later time. Because clearing and settlement, transmission of the message, and final payment happen immediately, those two things are not separated. And you cannot interoperate in that regard. Both the sending bank and the receiving bank have to be on the same system. They have to be able to talk to each other instantaneously, and they have to work in such a way that those funds are transferred and available immediately. So we are not optimistic that these two systems will be interoperable.

Senator MORAN. Thank you for your comments.

Again, Ms. George, Mr. Selgin's comments about holidays, weekends, and 24/7 caught my attention. What is the Fed response in that regard?

Ms. GEORGE. So a real-time payment system will be operating 24x7x365, and that will include holidays and weekends. The question that Mr. Selgin raised is one of how expanding hours for funds transfer might facilitate the private sector service in providing real-time payments. Because that is a systemically important system, we will have to look at and do the operational analysis on what it means to provide real-time expanded hours, and we have committed to do that in the public notice that we have put out to see what issues that raises, recognizing that there would be benefits to the private solution.

Senator MORAN. Mr. Hunter, let me return to you quickly. I think the RTP system has been up and running for about a year-and-a-half. What benefits are consumers and businesses seeing as a result of that? And what can we expect in the future those benefits to then be?

Mr. HUNTER. Thank you, Senator. Let me start with consumers first and then go to businesses.

For consumers, it really fundamentally is a safer, more efficient way to make payments. From the sender's side, they can get immediate confirmation that the recipient of that payment actually has the funds. So think about if you're paying your power bill and you are late and you want to make sure that payment gets there today, you have got immediate confirmation that you have been able to do so.

We also have extensive rules in place so that consumers who use alias, so if you type in a phone number or you are using a directory of some kind, the consumer gets confirmation of the real name. So if somebody types in or fat fingers my email address, they are going to get a message back that says, "Did you want to send that payment to Rob Smith?" "Well, no, I did not." So very, very important.

In terms of folks who are being paid and have to go to payday lenders or check-cashing services, if their employers are using the RTP system to make payment, they will have immediate access to those funds. They will not have to go to those services anymore.

On the business side, also incredibly transformational. They can get payments into the hands of a supplier, for example, for real-time inventory. They do not have to rely on credit anymore, and that supplier can ship those goods with confidence that they have been paid. They can attach just about anything that you can send over the Internet, an invoice, a picture showing that work has been done. So if you are a plumber and you want to convince your customer that, "Hey, I have installed this faucet and it works. Here is the video. Here is the photo."

If you attach the invoice to what is called a "request for payment," you can automatically associate that payment with the invoice and you do not have to do reconciliation on the back end.

Senator MORAN. Thank you. My time has expired. I will ask some other witnesses questions for the record.

And I, too, need to join the Ranking Member in the Veterans Committee. I will try to return, Mr. Chairman.

Chairman CRAPO. Thank you.

Senator Jones.

Senator JONES. Thank you, Mr. Chairman. And thank you to our panelists for being here.

Ms. George, I would kind of like to focus a question here on timing. Frankly, it is a little embarrassing, I think, that we are so far behind, and the Fed's payment obviously is going to be a complicated, really technical endeavor, and I believe your deadline is like 2024, which is in technological terms seemingly a lifetime away. It is only short if you are planning on one of the legions who are running for President and you are already making your plans.

What are you going to do, what is the Fed going to do—you know, benchmarks, do you have benchmarks already in place that you are going to be setting, that you are also going to deliver to Congress to keep us apprised of what is going on between 2024 to make sure that you are on track? Do you have those?

Ms. GEORGE. So we are beginning now to define what the features and design of this system could be, which will guide our delivery times, and we do intend to be very transparent with how that plan comes together, making available to the public our intentions, and we will certainly be coming back with future public comment as we design that system, and that will include our delivery and planned implementation.

Senator JONES. I take it that you really do not—and I am not being critical, but the benchmarks have not been set yet. You have not set that timeline just yet but you plan on doing that sometime after the comments within the next, what, 6 months maybe?

Ms. GEORGE. We are working on that immediately, so we are beginning that phase even now. And as the comment period ends in November, we will be compiling the input that we get from the industry on how that system should look. That will inform our delivery.

Senator JONES. All right, fine. Thank you.

For the panel, anybody that can answer this, we have obviously seen these kind of payment systems in other countries. They have been up and running, and there has been the good, the bad, the ugly, I assume, with these. What lessons are we learning from examining those? What lessons are we taking that we can incorporate? What lessons are we learning where mistakes have been made, mistakes that we want to avoid? I will just kind of open that up to the panel.

Ms. GEORGE. So I would be happy to start. Core to this work we have been doing has been looking at what other countries have done and their experiences, and we have learned from those.

One thing that makes it challenging to compare is that we have a very complex and diverse financial system. Some countries have a smaller number of institutions, and so the issues have varied. I think one thing we have taken away from this is the importance of getting input from the financial institutions themselves to understand their ability to adopt the technology, to connect to it, and to think about security around that. Those have been the areas of our focus throughout this work.

Senator JONES. OK. Mr. Hunter.

Mr. HUNTER. Yes, Senator, so we have had extensive dialogue with the payment system operators of real-time payments around the globe. One of the benefits of coming late to the market actually is the ability to learn from other countries and their experience.

The design and operation of our payment system is absolutely informed by lessons learned around the globe. One of the things that you will see in our payment system is that it is credit-push system only, and let me explain what that means. There are no debit pulls, so if somebody gets a hold of your account credentials, sometimes they can try to defeat bank fraud systems and draw money out of your account. With the RTP system, the only way that you can send a payment is you have to authenticate into your banking platform and you have to affirmatively tell the bank, once you have been authenticated by the bank, that you want to push money out to somebody else, so nobody can pull money out of your account.

We have incorporated what is called "ISO 20022 messaging". That is a little bit technical. But it is a global messaging standard that at some point in time in the future, if we want to, you know, connect these real-time payment systems around the globe, it is a messaging standard that allows us to try to do that.

Also, the way that we settle, in terms of the settlement account that we use at the Federal Reserve Bank of New York and the prefunding of that account eliminates credit risk from any institutions. So to Ms. Bair's point, if an institution fails to fund that account, their payments do not flow. There is absolutely no credit risk to the system or any other financial institution as a result of the failure of any bank.

Senator JONES. All right. Anybody else want to take a shot at that or respond?

Mr. STEEN. I would just use an example of our small bank. We have leveraged real-time payment over the SPEI network in Mexico, where a family member could arrange for a payment in Mexico from having lunch in Solon, Iowa, from a mobile device to an ATM withdrawal in real time. So we learned that things are possible, and those funds are prefunded in Mexico, so there is no credit risk. But it would be much better if we could link up our real-time capability on this side of the border.

Senator JONES. All right. Yes, sir?

Mr. SELGIN. The British system, which is often treated as a model of an early fast payments system, offers an interesting example of the challenges involved when you do not have central bank settlement services that are working on weekends. And here it is a challenge for real-time payments.

What that means is that they can have transactions in real time all weekend, but they do not actually finally settle up until the CHAP system, which is their equivalent to Fedwire, is open again on Monday. Now, that means that for banks that are releasing funds, funds are made available instantly, but there is credit risk assumed. The way they solved that problem in England is through something called the "liquidity and loan"—pardon me, "liquidity and loan-sharing agreement," and all the banks contribute collateral to a fund so that if any bank were to fail over the weekend, there is this fund that they can draw on.

In the U.S., you could not do that with all the banks involved. You could not possibly get them all on an agreement like this, and that is a reason why 24/7 settlement on Fedwire really is important to avoid risk. In our case, what the Fed would do if it did not have those facilities for Fedwire with its FedNow system, is incur the risk, which means we would incur the risk of these overdrafts that essentially would be taking place sometimes for long weekends.

Chairman CRAPO. Thank you.

Senator Toomey.

Senator TOOMEY. Thank you, Mr. Chairman. And thank you to the witnesses.

I just want to see if we can get a little bit more clarity about something that has come up. Mr. Hunter, my understanding is that the RTP has made an explicit commitment to provide flat fees on the transactions. As I understand it, that means regardless of the size of the transaction, the volume of the transaction, the size of the institution, all transactions would be treated the same, with one caveat, and that caveat is, if the Fed operates a parallel system and starts to offer a discriminatory pricing structure, that the RTP may have to move in that direction under that—is that about right?

Mr. HUNTER. That is correct, Senator. It is similar to what happened in the ACH.

Senator TOOMEY. OK. So, Ms. George, let me ask you a question. Has the Fed made an explicit commitment that its system will, guaranteed, offer only a flat fee payment—fee structure?

Ms. GEORGE. We are in the process of designing the system. We have not identified the pricing that will be associated with it, although once we do, we will make that public.

I would just say on the issue of pricing, volume pricing is common in the marketplace today, and it is often a way to take high fixed costs and make sure that you are able to maintain the adequacy of the system. Pricing today has allowed for market share to expand with private sector operators and has been viewed as being a fair pricing structure through numerous reviews.

Senator TOOMEY. Thanks. This is very interesting because what we have is the existing system is committing to not introducing a discriminatory pricing mechanism. The Fed is not making that commitment at this point, and, in fact, our representative from the Fed is observing that sometimes there are benefits in having pricing discrimination, which I acknowledge that is entirely possible. But for those who are concerned about which of these two is going to have discriminatory pricing, it is a little bit ironic. It is the RTP that is committed not to doing so.

Another concern that I have is interoperability. Mr. Hunter, I am going to give an example that I think of—and maybe I have got this wrong, so maybe you could help me, make it clear. Let us say an Allentown manufacturer has 1,000 employees, and they are scattered around the country. They inevitably have different banks that they use for their personal banking. The Allentown manufacturer has a bank that they use to process their payroll, and the Allentown manufacturer would like to be able to deliver payroll in real time so that their employees get the money instantaneously when it is available.

If some of the employees use banks that are part of a Fed system while the Allentown manufacturer has a bank that is plugged into the RTP system and the two systems are not interoperable, is it still possible for everybody to get their paycheck in real time on time? Or does that create a problem?

Mr. HUNTER. So it is certainly not easy, Senator. What the manufacturer would have to do is they would have to work through two different banks, and it would have to format the payroll according to the specifications of either system. So it will have to work through a FedNow bank to reach the endpoints on FedNow and their customers, and it will have to work through an RTP bank to reach the endpoints on that system, those banks and their customers. So it creates a lot of inefficiency and probably added expense.

Senator TOOMEY. Added cost, added inefficiency to have a second bank playing this role. One of the things I hear from time to time is that the RTP has not achieved ubiquity yet. With the likelihood that there will be a Fed-run alternative in the not too distant future, could that be contributing to the reason that some banks are holding back in participating with the RTP system?

Mr. HUNTER. So, Senator, we certainly saw a chilling effect of the original Fed proposal, which came out 11 months after we launched. So I think the initial reaction to that was we do not know what the Fed is going to be doing, we need to wait and figure that out.

Since the Fed has come out with the FedNow proposal and indicated that they will not be in the market for another 4 or 5 years, I think it is really sort of splitting the market, and it remains to be seen how financial institutions are going to react. There are certainly some financial institutions who have indicated that they do not feel that they can or should wait 4 or 5 years to bring the benefits of real-time payments to their customers. There are others who may wait.

Senator TOOMEY. One last quick question. This is for Mr. Selgin. Back in 2013, as I understand it, the Fed launched what they called the "Strategies for Improving the U.S. Payment Systems" and stood up the Faster Payment Task Force. And, effectively, the Fed, it seems to me, was calling out the private sector to improve the payment infrastructure.

The private sector responds, spends over a billion dollars on this project, more money individually to integrate with this system, and went live in 2017. And then 2 years later, the Fed announces it is going to stand up a competitor.

Given that sequence of events, do you think that has a chilling effect on the private sector's willingness to invest in the future and innovation certainly in the payment space but perhaps in other spaces as well?

Mr. SELGIN. I should think so, Senator. Mr. Hunter can answer better than I can, but I cannot see how it could have but a chilling effect. This effort by The Clearing House was undertaken entirely in response to that initiative and with the Federal Reserve's blessing and ultimately with its complete approval of the scheme that The Clearing House had come up with. Then only after that and after the system was up and running did the Fed decide it was going to compete head on in this same payment service.

I want to add, since it is relevant, that the idea that what is happening with what The Clearing House is doing is taking over an infrastructure that belongs to the public sector, that is a complete misunderstanding of the history of payments in this country. The Clearing House is much older than the Federal Reserve, and in many countries, not just the United States, most payments services are provided by the private sector, many of them at least, sometimes in combination with central banks but often alone. Central banks have their specialty, which is providing cash and also the ultimate settlement services. And as I said earlier, the Fed is not doing that last job very well because it is limiting—after years of being asked to do otherwise, still limiting the availability of final settlement services. And by doing that—and this is extremely important—it is not the case that you need fast payments, in the sense of instantaneous payments, to solve the problem of it taking days for workers to have their checks clear, et cetera. That problem can be solved just by making the existing Fed wholesale settlement systems 24/7/365. The plan that would solve that problem that the Fed is now pursuing will take 5 years. That is all those people waiting for those checks to clear or those payments to clear will have to wait for at least that many years, except to the extent that they can turn to RTP. And that should not be the case. That is a terrible dereliction of the Federal Reserve's duties to the public.

Senator TOOMEY. Thank you, Mr. Chairman.

Chairman CRAPO. Senator Cortez Masto.

Senator CORTEZ MASTO. Thank you, Mr. Chairman. And thank you all for being here this morning.

President George, let me start with you. I want to follow up on the questions that Senator Brown had asked. Do you think it is important to consider the possibility that the Fed would have to bail out one or more of the TCH banks if they were the only real-time payment system?

Ms. GEORGE. I think our experience is that we do not, for the smooth functioning of the U.S. payment system, want a single point of failure. And history has shown during times of stress that having the central bank as a provider of payments has served the country well.

Senator CORTEZ MASTO. OK. And as we talked about cost recovery, because that is part of the conversation as well, and because of your concern, because you do not want that single point of failure, should that factor into the Fed's cost recovery estimate?

Ms. GEORGE. It will factor into—any cost of our system is required under the Monetary Control Act to be fully recovered, and we intend to do that with FedNow Service.

Senator CORTEZ MASTO. Thank you. And so, Ms. Bair, Chair Bair, can you add your thoughts on the potential risk of a bailout in the conversation we are having today?

Ms. BAIR. Yes. I think as President George said, you have a single point of failure if you have just one system. Payments, it is kind of important. You disrupt payments, you get a catastrophic situation with commercial activity and consumer activity as well. It is not clear to me—the RTP system is untested. They have designed it to prevent credit risk. I give them that. But they maintain a centralized ledger, and we have got to have confidence that that centralized ledger will prevent negative balances in their joint account.

It is possible, as acknowledged, it is possible for a large bank to lose the capacity to continue to fund the joint account, so maybe the other banks participating in the joint account are still OK. My question is: What happens to the customers at that bank who are using it?

So I think there are a lot of unanswered questions about how resilient it will be during a crisis, and so nobody is saying we should not have RTP. Good. I am glad we have RTP. But we should have another system, too. Competition is always good, and the Fed is much better equipped to continue to function and its track record is such to operate in good times and bad under extremely stressed conditions. And if we just had this one system, if it does disrupt, the Fed is going to have to come in anyway with a much messier and inefficient way of trying to stabilize the system again.

Senator CORTEZ MASTO. Thank you. While I have you here, we have been have conversations here in this Committee on this issue, and, Chair Bair, in your testimony you urge the Fed to fully explore the use of digital currency.

Ms. BAIR. Right.

Senator CORTEZ MASTO. Including cryptocurrency based on a distributed ledger technology and effectuating real-time settlement between banks. Why do you think the Fed should consider developing a central bank digital currency that could eventually be used by members of the public to transfer money directly between——

Ms. BAIR. Well, it is still a maturing technology, but it is maturing rapidly. And, clearly, having a distributed ledger that all banks would have access to, you do not need an intermediary. You do not need a TCH. You do not need a centralized ledger in that single point of failure. The digital transfer is directly from one—the sending bank to the recipient bank. So, yes, I think it needs to be explored. It is still maturing. No other central banks have done it, but a lot of other central banks are looking at it, and I hope that is something that the Fed will continue to explore as they build this system.

It also helps address some of the interoperability issues that we were discussing earlier, but I would like to just—you know, Mr. Hunter has insisted that RTP cannot be interoperable, and I would just note that that kind of reinforces their monopoly position if his view is that their system—real-time payments is somehow incompatible with interoperability. And interoperability is a two-way street, and I would hope that TCH would sit down with the Fed and try to agree on common standards and figure out a way these systems can most efficiently interact. If he wants to say, no, nobody else can play, then, you know, if you do not have the Fed, then that just solidifies their monopoly position as a single provider of this crucial function.

Senator CORTEZ MASTO. Thank you.

President George, to what extent is digital currency and the future of it being—are you considering that as you move forward with this payment system?

Ms. GEORGE. The Federal Reserve and other central banks are looking closely at how this evolving technology is affecting the financial system and will continue to do so.

Senator CORTEZ MASTO. Are you watching what is going on with Libra?

Ms. GEORGE. We are watching that also, so the full range from distributed ledger to digital currency is very much under study as we see how those unfold.

Senator CORTEZ MASTO. Thank you. Thank you all again for being here.

Chairman CRAPO. Thank you.

Senator Tillis.

Senator TILLIS. Thank you, Mr. Chairman, for holding this hearing, and thank you all for being here.

Mr. Steen, I want to let you know that I joined with a group of Republicans and Democrats that recognize that small banks and community banks have regulatory burdens on them that we thought were inappropriate. That is why we joined together against the objections of the Ranking Member of this Committee to provide you all with regulatory relief. This may be an issue where you and I want the same ends, but maybe achieve it through a different means, and that is really what I want to talk about.

Ms. Bair, you mentioned in your opening statement that this was a measured and deliberative approach to decide to come up with a payment system. I understand that a part of that is engaging an outside firm to try and figure out what is wrong with RTP and The Clearing House, and that the conclusion that those outside consultants made was that most of it is working right, some of it needed to be addressed.

And so I am wondering why we seem to be going with this alla prima approach versus trying to address some of the legitimate concerns Mr. Steen and others would have with using RTP.

Mr. Hunter, Ms. Bair also mentioned in her opening statement about the private sector approach could subject—in a future crisis subject us to bailouts. Under what scenario would The Clearing House or RTP be in a position to where it would need to get—I understand the investing—I know the banks that stood this up, and I understand them. But I am trying to understand under what scenario—I understand that you performed very well during the crisis. I do not think that you required a bailout. I do not think that there were any outages. I do believe that Fedwire has experienced some outages and does have some resiliency challenges that they need to deal with, and availability. But under what scenario would you actually be subject to a bailout request?

Mr. HUNTER. Senator, there is no circumstance where we would be subject to a bailout request. I mean, we have detailed processes in place to deal with banks that are on our systems that have been worked out with the FDIC for resolution of those banks, and Ms. Bair may not be aware of those given her position at the FDIC. But we worked very, very closely on bank resolutions, and there is no risk to the system. They are architected in such a way that that just does not happen. So those circumstances, Senator, simply do not exist.

Senator TILLIS. Another question really going back to the measured and deliberative approach. It is my understanding—and, Ms. George and Mr. Hunter, maybe you can illuminate, but under—the Bank Service Company Act of 1999 provides fairly significant or broad authority but for some reason it appears as though the Fed does not think that it has the authority to engage with the private sector, to engage with The Clearing House or RTP to address some of the concerns you may have, maybe concerns that Mr. Steen has.

So why wouldn't a part of that deliberative approach be a discussion about expanding the regulatory perimeter so that you could address those concerns with a private sector solution? I will start with you, Ms. George.

Ms. GEORGE. Thank you, Senator. The Board of Governors explored this issue and highlights it in the *Federal Register* notice that they believe those authorities were not adequate. And, clearly, the Federal Reserve——

Senator TILLIS. OK, but why not a discussion about expanding the authorities to the extent that you could address what we are now thinking about a major undertaking that will take 5 to 7 years. I am a technology person. I think it is probably plus 5, closer to 7, and a lot of cost. So why wouldn't there have been a discussion of if you have concluded that you do not have sufficient regulatory authority to come back and come to Congress and ask what that may be?

Ms. GEORGE. I think because our experience under our existing authorities of Congress of providing these services as an operator have been so effective throughout history that it led us to rely on those existing authorities and provide the competition that has served the country well, and that was the conclusion I think that you see in the Board of Governors' analysis.

Senator TILLIS. Mr. Hunter.

Mr. HUNTER. Senator, thank you for the question. The Federal Reserve—not only the Federal Reserve but, frankly, the OCC and the FDIC have broad regulatory authority over The Clearing House. Basically any regulatory authority they have over a bank that they supervise is the same regulatory authority that they have over The Clearing House, and I quote extensively from the Bank Service Company Act in my written testimony, and I would direct you to those statements.

But in addition to that, as Congress has enacted in this country, we have detailed competition laws that we are subject to and the Federal Reserve is not, but the private sector is subject to, and the Department of Justice stands ready to enforce. So when you talk about anything related to pricing or monopoly power or acting in an anticompetitive way, which the Federal Reserve speculates that the private sector could potentially do at some point in time, those are illegal activities under the laws of this country. We have never engaged in those activities. But if we ever did or if any other private sector ever did, there are laws in this country that protect against that.

Senator TILLIS. I have a number of questions. I, too, have to go to the Veterans Committee. This is very important to me because I think in some respects—I view the current Fed proposal as a $100 saddle on a $10 horse. I think there are some things that we may be able to do to address some of the concerns and make sure community banks are treated properly to avoid potential future discriminatory practices on pricing, resiliency questions, interoperability questions, the kinds of things that you are going to have to get into. So I will be submitting a number of questions for the record for you all, and I appreciate you all being here.

Chairman CRAPO. Senator Van Hollen.

Senator VAN HOLLEN. Thank you, Mr. Chairman. I thank all of you for your testimony today.

Moving as fast as possible to real-time payments has been a priority of mine. I have talked to lots of witnesses that have come before this Committee on this matter because the lack of a real-time payment system is costing millions of Americans billions of dollars every year. So, President George, I commend you for your leadership in this issue. I know it is an issue you have thought about a lot, and you have been very thoughtful in developing these proposals.

I have listened to the testimony. A lot of ground has been covered. I do think the fundamental question gets down to this issue of competition, and I realize that The Clearing House says it welcomes competition on the one hand, but on the other hand, all the testimony here today is let us not have a separate FedNow system. And it seems to me that keeping that monopoly position in the hands of the 15 biggest banks is not necessarily in the long run the best deal for consumers. And a little competition is a good thing, in my view.

Mr. Steen, you represent lots of financial institutions, and you are obviously looking out for your consumers and your customers here, and you have expressed a real fear in your testimony and earlier statements about handing over this kind of monopoly power to this kind of monopoly. And you actually raised before this hearing the same issue that Senator Toomey raised here, which is when the Fed said it might get into this space, The Clearing House then said, well, you know, we made this promise about not engaging in—you know, not changing pricing in a discriminatory way, but, you know, we are going to have to reconsider that, which, in fact, in my view just underscored the need to have an alternative here.

You are someone who is working this issue on the ground every day. If you can just—you know, how would you explain to one of your customers coming into your bank why you think it is important for the FedNow system to be put into operation?

Mr. STEEN. Well, Senator, thank you. You know, my customers are looking to us to provide them the fastest payment possible, and I need to ride that train. And the one constant in my career has been the Federal Reserve. From a pricing standpoint, they have demonstrated when technology improves, they lower my cost, and they explained that to us and we understand it.

So I just know that we cannot lose that, and I know accessibility to every small financial institution is just so critical, and we are one of those. And so I am absolutely confident the Fed is doing the right thing, and we have been asking them to do it. I was on the task force. I was on a steering committee. I was in the directive work group, and I have been pounding the table for them to do this all the way along the way. And they are, and I am confident it will move along very quickly. I saw what they did in Check 21 and how fast that revolution took place, and I was part of that. So I am confident we can accomplish this.

Senator VAN HOLLEN. Thank you. And I would point out, as the Chairman knows it was a 4–1 vote on the Board of the Federal Reserve.

Ms. Bair, you have been in the middle of this during really tough times in terms of, you know, financial institution in our country. In response to a question, you just pointed out that this suggestion that we could not make these systems interoperable was kind of like the statement on monopoly and discriminatory pricing, another example actually of why it is important to have an alternative, right? Because, otherwise, the system with monopoly power can use that leverage in certain ways. Can you expand upon your concern there?

Ms. BAIR. Yeah, because I think it is important to understand we are talking about interbank settlement. So there are a lot of banks working with financial technology companies trying to come up with new, innovative ways to help people send and manage payments that are customer-facing, but you still have the problem of getting the money from one bank to another. And so if you have a monopoly provider for that piece of it, all these other innovators that are working on customer interfacing services and applications will have to go to that single provider. This is why—you know, I know the big banks love this, but pretty much nobody else does. There is no trust. The small banks do not trust them. The financial technology companies do not trust them because this will be giving them monopoly pricing power. And they may say today, "We will not do it. We will be fair and equitable." But the Fed has no authority to regulate rates.

I also agree with President George that the best way to address this is through competition and giving smaller institutions, giving financial technology innovators working with those institutions an alternative, giving them two places to work with, to deal with, to support their innovations.

And I would also say that the problem of trust is one of the reasons why I do not think RTP has gotten traction. If there was trust, if it was a great service, who cares whether the Fed is going to come in anyway? People will be jumping for it. But that is not happening. The public comment process has overwhelmingly said that pretty much everybody outside the big banks who own TCH want an alternative system.

Senator VAN HOLLEN. Thank you. Look, I think the history shows that competition actually spurs innovation, not stifles innovation.

Thank you, Mr. Chairman.

Chairman CRAPO. Thank you.

Senator Kennedy.

Senator KENNEDY. Thank you, Mr. Chairman.

This debate—and I have not made up my mind on this. This debate reminds me a lot of the debate we are having in health care about whether the U.S. Government should set up its own health insurance program to compete with the private sector. That is just an observation.

The second observation, Mr. Steen, I have great respect for the Fed, and I would remind you, though, that it was the Fed, or at least people influencing the Fed who decided in 2008 that the community banks were just as responsible as the too-big-to-fail banks for the meltdown, which was patently untrue, and some people around here decided to try to regulate you and your colleagues half to death, which I think hurt the banking system. So I would just caution you, up here in Washington do not trust anybody pretty much.

President George, let me ask you this, and this is honestly a question. I do not mean the question to suggest an answer. Tell me what is wrong with RTP. Is it not working? Can it not work? What is your concern?

Ms. GEORGE. So I have no insight to the functioning of RTP, but we have encouraged private sector innovation in this space, and for many years——

Senator KENNEDY. May I stop you a second? If you have no insight into RTP, then why do you want to set up something to compete with it?

Ms. GEORGE. Because our interest in making sure under our public policy goal that access is broadly achieved for this service and extends to some 10,000 institutions in this country, and we have an existing network, reach, and relationship with those institutions.

Senator KENNEDY. I get that, and I am sorry to interrupt you. But what I want to understand—I mean, doesn't the Fed have enough to do? It would just seem to me that if RTP can work—if you want to compete with it, that may be the right approach. But what I am trying to understand is why. I understand you have the power to do it, but why does it make sense to spend taxpayer money for the Fed to go set up a competitor for something that may be working? Unless it is not. If it is not working, tell me.

Ms. GEORGE. The information we received from the faster payments task force came to the Fed and said we need the Fed to get into providing real-time payments with the private sector.

Senator KENNEDY. Why?

Ms. GEORGE. The reason was to achieve broad reach. We have many community banks in this country that are in rural and remote areas that would not otherwise be profitable places to provide services. They need these services for their communities. They need to be able to attach to systems that might otherwise be out of their reach.

Senator KENNEDY. OK. May I stop you a minute? I am not trying to be rude. Our time goes so fast.

Ms. GEORGE. Yes, sir.

Senator KENNEDY. So why don't—I mean, the Fed has the power to punish banks the rest of their natural lives. You and I both know that. I know you do not put it in those terms, and I am not suggesting anything untoward. So why don't you turn to RTP and say, "Look, here are some changes we would like to respectfully ask you to make? You do not have to make them, but our advice is you should." They are not going to ignore you, are they?

Ms. GEORGE. I think our experience is operating alongside the private sector has produced the best outcomes for the payment system.

Senator KENNEDY. But my question is if you see a way to improve—I am trying to understand. If you see a way to improve RTP, why don't you just sit down with them and say, "Folks, we want you to extend your reach. We want you to give us jurisdiction over the prices you are going to charge, and we want to make sure that you make your service available to everybody"? Boom, problem solved.

Ms. GEORGE. The Board of Governors——

Senator KENNEDY. Then you save a bunch of time and money, and you do not have to set up a competing system, because taxpayers are going to pay for what you are going to set up. And I know you have enough to do.

Ms. GEORGE. We certainly have enough to do, and we are intent on fulfilling our public policy authorities as Congress has granted us in this arena, which is to make sure that that system is accessible, that it is provided equitably, and that it is safe. And we will continue to operate alongside the private sector in achieving those outcomes for the public.

Senator KENNEDY. OK. Can I ask one more, Mr. Chairman, since it is just—oh, I am sorry. I do not want to cut in Senator Smith's time.

Senator SMITH. Go ahead, Senator Kennedy. One more. Just one more.

[Laughter.]

Senator KENNEDY. Well, Ms. Bair is raising her hand.

Ms. BAIR. Well, I did. I just wanted to strongly support what President George said and indicate that I hear what you are saying about—so, first of all, you do not have regulatory authority, I think, so there is no direct authority to do rate regulation and access controls and all the kinds of things——

Senator KENNEDY. Yeah, but then—the banks are not——

Ms. BAIR. If I could just——

Senator KENNEDY. ——ask them to do something.

Ms. BAIR. I wish that was true. But as a Republican, as somebody who considers herself market oriented, I think competition is a much better discipline on pricing equity and efficiency and broadening customer bases than trying to prescriptively regulate this, so——

Senator KENNEDY. Well, that is one point of view. Another point of view is you just want to expand Government.

Ms. BAIR. No, I do not think that is what the Fed—look, I worked with the Fed for a long time, and I criticized, you know, other parts of the Fed. I advocated for limits on the Fed's bailout authority. They probably were not happy with me. Chairman Crapo remembers that in Dodd–Frank. So another context, you know, sure, the Fed has got a lot of power. But this is like the bread and butter of what they do, and they are the only ones who can come in with an alternative parallel system because of the costs and the resources that are required to do this. If you just rely on private enterprise, there will be a single monopoly provider without the regulatory authority to impose pricing and access controls. So I do think the Fed is absolutely—this is in the public interest to do, and it will be more efficient than just trying to regulate it with authority they do not have. And I think big banks push back quite a bit against the Fed and the FDIC, so I would not say that they always do what the regulator asks them to.

Senator KENNEDY. Thank you, Mr. Chairman. I am sorry, Senator.

Chairman CRAPO. Senator Smith.

Senator SMITH. Thank you, Mr. Chairman. I just realized I might have accidentally taken some of your authority by ceding time to Senator Kennedy without your permission.

Chairman CRAPO. No problem. You are welcome.

Senator KENNEDY. You are on double-secret probation.

[Laughter.]

Senator SMITH. I want to thank all the panelists for being here today, and I am sorry I missed the back-and-forth with my colleagues, because, as you have no doubt heard, we have lots of committee hearings today. I am sure the ground has been well plowed here.

Let me just ask a question of President George. President George, the Fed operates several payment systems already, and I am wondering what you have learned about fraud prevention from that experience. You know, there are many upsides to real-time payments, but, of course, one of the possible downsides is real-time fraud. So could you just share a little bit about what you have learned about that?

Ms. GEORGE. The security of the payment system is essential and I think, as you have noted, in particular when payments are moving this quickly. We would see as part of our initiative—and as we did with the faster payments task force—thinking about security and what fraud mitigation standards will be important. And I think that will include education efforts, the banking system making sure that their customers understand what role they play in that.

Senator SMITH. Thank you.

Would anybody else like to comment on that fraud question?

Mr. HUNTER. Absolutely, Senator. So we take consumer protection very seriously. We worked closely with the CFPB in our design and establishment of this system, and we have learned a lot about fraud from our interactions with other real-time payment systems around the world.

Fundamentally, the way we have architected this system is a much better, much more safe, much more secure experience for consumers and businesses because these are credit-push payments only, so the consumer or the business have to actually authenticate into their banking system, and the only way that they can make a payment is to push those funds out. There are no debit pulls where, if somebody gets a hold of your account information and they can defeat the fraud control systems of the bank, they can get money out of your account. So, fundamentally, this is a much more safe, much more efficient, much more sound way for consumers to make payments.

And if I can, Senator, I just want to say that, you know, we will certainly work and have discussions with the Fed about interoperability. I do not mean to imply to anyone that we are not concerned and would not want to get there. When we talked about designing the system, we had hoped that interoperability could be achieved. We are not optimistic. But we are certainly willing to do everything possible to discuss with the Fed and try to reach that result.

Senator SMITH. Thank you.

Just another question that is very specific. It was raised to me specifically from Minnesota credit unions, of which we have many, and they are very important to communities in Minnesota. Small credit unions are trying to figure out—you know, they do not have staff available 24 hours a day to monitor transactions and troubleshoot problems. And so my question to the panel is: How can small institutions prepare to handle a payment system that would be on

24 hours a day? What would be the solutions, just the operability solutions for small institutions?

Mr. HUNTER. Senator, if I may, we have worked very, very closely with third-party service providers, and one of the things that we have recognized is that they are going to need—banks like Mr. Steen's bank, other community banks, we want all of those banks to be on the RTP network because the network is only as valuable as the banks that it can reach. So third-party service providers, bankers' banks, corporate credit unions, other institutions that provide critical services, back-office services to small community banks and credit unions have been on our radar ever since we designed the system.

What you have seen are large banks who handle their own technology coming onto the system to date. What you have not seen but is equally important and was maturing is the work that we have done with those third-party service providers to bring small financial institutions onto the system. They have begun to be in a position to activate those core back-office systems, and they are going to start bringing on small community banks and credit unions in the next several months.

Senator SMITH. Thank you.

President George, would you like to respond?

Ms. GEORGE. This is a real issue for small institutions, credit unions, small banks, and we will be working carefully around standards, which I think help them in adhering to things that protect them and protect their customers.

Senator SMITH. Thank you. And just one last question. Let us say I am just a person—which I am—and I am trying to—and I can see that real-time payments, you know, whether I am a small business—you know, this is going to be helpful to me. So can anybody explain to me, what is the harm of more competition? To me, how am I harmed as an individual if there is more competition rather than less competition in this market?

Mr. HUNTER. So, Senator——

Senator SMITH. I am going to just ask Ms. Bair about this.

Ms. BAIR. Well, I think consumers are helped. It will result in more innovation, more competition, better pricing, wider access. I think absolutely two systems will support consumers and their ability to have a choice of real-time payment services and for all banks of all sizes and depository institutions, including credit unions of all sizes, to be able to participate. And this is the future. We will have real-time payments, and so the challenge is to make sure everybody is included. Having these two systems is the best way to do that.

Mr. HUNTER. Senator, if I may, we——

Senator SMITH. I am sorry, but I think Mr. Selgin was going to speak; then I will let you——

Mr. SELGIN. Yes, I was going to say I am not one of those who opposes competition between the Fed and the private sector, including The Clearing House. What I am concerned with is that the competition has to be fair. If any of the players can cheat or can compete unfairly, to put it a little bit more mildly, that can upset the competitive process that normally leads to good results. That is why we have the Antitrust Division, for example, to make sure private firms do not compete. In the Fed's case, we have to take—there are other precautions that are needed. Some are taken already, but there are many ways in which presently the Fed can compete unfairly, and a few have been mentioned. One of them is not paying interest on reserves held in joint accounts that serve the same purposes as other reserves—not classifying funds in those accounts as reserves. They should be classified that way.

Another is by not making its essential clearing services, settlement services on Fedwire and on NSS available 24/7. That allows other non–real-time payments systems to compete more effectively by having faster payments, but not necessarily non–real-time payments, and there is competition on that margin, too.

So there are a lot of steps Congress can take to assure that competition is played on a level playing field between the Fed and the private sector. That is the key, not preventing competition.

Mr. HUNTER. And, Senator, if I may, we are not against competition. Let me make that perfectly clear. What we are concerned about is an unlevel playing field between the private sector and the Government.

We are also concerned that if we cannot figure out interoperability—and no systems worldwide interoperate in real-time gross settlement payments like we have set up here. Nobody has figured out how to do that yet. That will lead to a very suboptimal result in this country for consumers and businesses where the participants and their customers on one system are not going to be able to complete payments to the participants and their customers on another system.

Senator SMITH. Thank you, Mr. Chair.

Chairman CRAPO. Thank you. And that completes the questioning, although I am going to ask for a brief response from all of you on an issue that Senator Cortez Masto raised. But first let me thank you all for bringing this perspective here.

We had the obvious divergence of opinions on the Committee here about this issue. I find it interesting. I think Senator Kennedy probably focused on the dichotomy of we all believe in competition; we also all talk about how we believe in not having the Government be too large and having the Government step in. Here what we are talking about is the Government competing with the private sector, and that kind of puts an interesting twist on the competition discussion.

And then the reverse of that is the discussion about, well, you have a monopoly if you only have one provider in the private sector, and so how do we deal with that? These are difficult questions, and as you can see, we have different perspectives on that on the Committee. I encourage the Fed as it moves forward here, which apparently it is doing, to take these kinds of considerations carefully into mind, and hopefully we will be able to work this out.

The question I want to address, however, is the one of digital currencies. As you are all aware, this Committee right now is dealing with the Libra proposal from Facebook, which is only one of the more recent utilizations of blockchain technology on the Internet but in the context of creating a digital currency, and we have many examples of this technological development on the Internet, Bitcoin and many others. But they raise the question, as I understand it, of whether we are moving technologically to a whole different world than the one which we spent this entire hearing discussing, and that world is digital currency-related technology, which perhaps our central banks as well as all of our financial institutions, small banks and large banks alike, credit card companies, every kind of transaction, need to be more focused on. And I would just a very huge question and ask you all to respond very briefly, and I really mean—perhaps what you could do is respond to me on this, just your thoughts about this issue in general, in writing following the hearing.

But am I correct that we need to start looking at this entire transition to—or whether there really is a transition. Is this a technological change that we should consider as being transformative in the way that we deal with currency and with financial transactions? Why don't we just go down the line? Ms. George.

Ms. GEORGE. Thank you, Senator. It is a very important issue, I think, because it is hard to forecast where this is going, and it is one of the reasons that we study carefully what it means, because one thing we know is we have invested heavily in trying to have a banking system that is sound, that serves the economy, that serves the American public. And, of course, with that has come safety nets, consumer protections, thinking about access to credit, many of those things.

As we look at what disruption may come to the existing framework, I think that is why it is important we study, to see how will any of those safeguards be disrupted, how will they apply in a new world with different technologies. At this stage, it requires us to be very cautious and look carefully to make sure that we gain the benefits of innovation, gain the benefits that can come from new technological approaches without undermining, I think, what has been hard–earned-and-won safeties for the economy.

Chairman CRAPO. Thank you.

Anybody else want to comment?

Mr. HUNTER. Senator, Mr. Chairman, I appreciate the question. We certainly share Ms. Bair's and other folks' concern about unregulated and largely unsupervised social media companies getting into setting up de jure currencies that could threaten the prominence and the value of the U.S. dollar.

That said, we have looked at digital currencies or blockchain as a technology throughout its development and deployment across the U.S., and it really is not terribly fit for purpose when you think about using it as a payment system. It takes an enormous amount of processing power. It is relatively slow. It does not sort of process the number of transactions that you need to process and the speed and the volume that you need to really serve the country.

I think it is one of the reasons why—I mean, this concept has been around for a long time. You do not really see it being deployed and used a lot for a payment system, and it is sort of deployed around the edges. It has not really caught on. Blockchain is a great solution for the Register of Deeds Office where you want records that go back until the beginning of time and you can create lots of information. But it is not terribly fit for purpose in the payment space.

Chairman CRAPO. All right. Anyone else?

Mr. STEEN. I do have some thoughts on that, and I would like to submit them to you.

Chairman CRAPO. I would appreciate that.

Ms. BAIR. I appreciate the question. I think you are right to focus on it. And something like Facebook's Libra would take payments completely outside of the banking system. We would lose substantial control. So whether it is technologically feasible or not, I mean, Facebook is a pretty smart company and has spent a lot of time on it. They seem to think it would. I think the lack of any kind of regulatory structure around that, you know, I would encourage the Committee to continue looking at that because the last thing we want is to lose control of our fiat currency, which is why I think ultimately central banks, including the Fed, need to get ahead of this technology and capture it themselves so that they cannot be disrupted by a large nonbank entity like a Facebook.

Mr. SELGIN. Yes, I would add, Senator, we have all been talking about the benefits of competition in the payments system, and these digital currencies are part of that potential competition, and they are a particularly important part because they represent some very intriguing innovations that have not come from Government, but have come from the private sector. We do not know the full potential benefits that may be had from these technologies ultimately.

Mr. Hunter is quite correct that so far they have not been particularly useful for payments, although people think of them as being used in that connection. They have a lot of disadvantages. But I think it is desirable that they, too, be part of the process.

As for central banks providing digital currencies themselves, well, it must be said that the paper notes that the Federal Reserve issues are the horse and buggies of the modern payments system and that digital substitutes for these could well be an improvement. But there once again we would want the Fed to be competing with private sector providers and not monopolizing the provision of these substitutes. And there is no reason why you could not have some private digital monies that are dollar-based, and we have things that are close to that so far. The main thing is that competition has to be allowed to work itself out amongst parties participating on a level playing field.

Chairman CRAPO. Well, thank you, and I appreciate these insights. I would welcome any further insights that you would like to share with me on this issue. It seems to me that this is—unless it becomes clear that it is such a cumbersome innovation that just cannot be utilized in the payments system or in the currency systems of the world, it seems to me that this could be truly a disruptive influence in—and I do not say that in a negative sense. I mean in the context of its impact on literally currency transactions of all types in the world. And some of those impacts could be very positive impacts; some could be very dangerous impacts. You think of things from eliminating cost to consumers in the system to expanding opportunity for money laundering and all kinds of other different potential impacts of the expansion of this new type of innovation. So I would love your thoughts on it as we move forward. This is obviously another issue that the Committee is currently struggling with.

With that, I want to conclude this hearing. Again, I thank you for all of your input and welcome your further input on this.

For Senators who wish to submit questions for the record, those questions are due to the Committee by Wednesday, October 2nd. I would ask the witnesses if you would all respond to those questions as promptly as you can, we would appreciate it. And, again, thank you for being here.

This hearing is adjourned.

[Whereupon, at 11:49 a.m., the hearing was adjourned.]

[Prepared statements, responses to written questions, and additional material supplied for the record follow:]

PREPARED STATEMENT OF CHAIRMAN MIKE CRAPO

Today, the Committee will turn its focus to facilitating faster payments in the United States.

Faster payments are important and yield economic benefits for both consumers and businesses by providing them with greater flexibility when managing money and making time-sensitive payments on demand.

Real-time payments offer efficiency and convenience, helping consumers to better manage their spending and avoid unnecessary fees and penalties, and helping businesses pay for goods and avoid other costly sources of funding.

Unfortunately, the U.S. has lagged behind other countries in the development of real-time faster payments for retail payments.

Recognizing this shortcoming, in 2015, the Federal Reserve organized a Faster Payments Task Force, made up of a diverse group of stakeholders, to encourage the development of a real-time payment system in the United States.

The Fed stated in its report on strategies for improving the U.S. payment system that it "would not consider expanding its service provider role unless it determines that doing so is necessary to bring about significant improvements to the payment system and that actions of the private sector alone will likely not achieve the desired outcomes for speed, efficiency, and safety in a timely manner."

Responding to the mission of the Faster Payments Task Force, The Clearing House announced in 2016 its intent to launch a real-time payments system, which it officially launched in November 2017.

Just prior to The Clearing House launching that system, the Faster Payments Task Force in July 2017 issued a final report, which offered several recommendations for achieving a safe, ubiquitous, and efficient faster payment system in the United States.

One of those recommendations was for the Federal Reserve to develop its own 24x7x365 real-time gross settlement system for retail payments and to assess whether there were other operational roles the Fed should play in faster payments.

After determining the Federal Reserve Banks should develop a new real-time gross settlement service, on August 2, 2019, the Federal Reserve Board voted on the Fed's proposal. The lone dissenter was Vice Chairman for Supervision Randy Quarles.

The Federal Reserve then issued a notice and request for comment on Federal Reserve Actions to Support Interbank Settlement of Faster Payments—a system referred to as FedNow.

In Vice Chairman Quarles dissent, he noted that "The U.S. private sector has a long history of providing efficient payment solutions to consumers and businesses."

He added that "The public sector should provide its own capacity only when the evidence of market failure is clear and alternative means to achieve public goals are not feasible. In this case, [Vice Chair Quarles] does not see a strong justification for the Federal Reserve to move into this area and crowd out innovation when viable private-sector alternatives are available."

Additionally, when providing a new payment service, the Federal Reserve is required to meet certain obligations and criteria before moving forward. Those criteria are: the Federal Reserve must expect that its providing the service will yield a clear public benefit; the service should be one that other providers alone cannot be expected to provide with reasonable effectiveness, scope and equity; and the Federal Reserve must expect to achieve full recovery of costs over the long run.

Throughout the Fed's process, some financial institutions have raised concerns about the Fed's analysis and process, the cost and amount of time it would take to develop its own real-time payment system, its prospects for achieving interoperability, inherent conflicts of the Fed operating its own system and its prospects for negatively affecting existing real-time payment systems.

Still, other financial institutions urged the Fed to move forward due to their concerns surrounding pricing, power and competition in the marketplace.

I strongly support better, safer, and faster payments in the U.S., including the work already done on existing solutions in the private market.

I look forward to learning more about numerous issues during this hearing, including: clear demonstration of the market failure or problem that the Fed believes it must solve through the development of its own real-time payments system; how the existing real-time payments platform works, how it has been impacted by the Fed so far and the consequences of the Fed developing a competing system; and how the Fed believes its proposed system could achieve interoperability, minimize negative effects to existing private sector participants, and fully recover its costs quickly.

I look forward to hearing from each of you on your views of faster payments in the U.S., and more about the existing and proposed platforms.

PREPARED STATEMENT OF SENATOR SHERROD BROWN

Thank you, Chairman Crapo, and thank you to our witnesses.

Whether it's Facebook thinking it can run its own currency, or big banks wanting a monopoly over our payment system, we can't allow corporations to take over critical public infrastructure, so they can squeeze more profits out of working families.

Whether you punch a clock or swipe a badge, every working American knows how important payday is. It's often the day you know you can pay your bills and make rent. But sometimes payday doesn't line up with the day your bills are due. And if that means a delay in paying the bills, banks will pile on late fees and overdraft charges, so it is even harder to make ends meet.

Recently, the Federal Reserve Board announced that it will develop a system to provide payments in real time. This is great news for millions of Americans who live paycheck to paycheck—for anyone who has waited for a check to clear or had to resort to a payday lender on Friday to tide them over until Monday. Faster payments will allow Americans to actually use more of the money they've already earned.

But while some of us see a problem to solve for working families, the biggest Wall Street and foreign banks see what they always do—dollar signs. They see another way to squeeze more profits out of the rest of us.

That's why they don't want the Fed to be involved. They built their own real-time payment system on top of existing Federal Reserve infrastructure, but we really don't know how it's governed, how much it would cost, or how they plan to skim more profits off the top for themselves.

We can't trust that the big banks won't charge more to community banks and credit unions. They've already changed their mind on their prices once, and there's no guarantee they won't change their minds again.

These big banks oppose the Fed's efforts because they want to be the only game in town. They want a monopoly.

We know what happens when we trust Wall Street.

Eleven years ago this month, Lehman Brothers failed, sparking the worst financial crisis since the Great Depression. Many of the big banks that are now asking for a monopoly over the real-time payments system are the same Wall Street banks that wrecked our financial system and came begging for billions in taxpayer money to save them.

And let's be clear—they haven't exactly cleaned up their act.

These same banks, like Wells Fargo, Bank of America, and Deutsche Bank, have been involved in scandal after scandal, creating fake accounts for customers, illegally foreclosing on servicemembers' homes, violating U.S. sanctions laws—it goes on and on. It seems like there's a new scandal every day. Capital One just suffered a huge data breach, exposing millions of customers' personal data.

And remember those overdraft fees and late fees and transfer fees that we're trying to protect workers from? It's these same big banks that slap on those fees. They created this problem, now they want to charge people again to solve it.

To make matters worse, this Administration is rolling back the safeguards we put in place to protect working families from the risky Wall Street activities that crashed our economy.

It was another financial crisis over 100 years ago that led us to create the Federal Reserve, to clear payments and govern our currency. Congress recognized the high fees and abuses going on in our payment system and understood that we needed a publicly run central bank to provide financial stability and fair access to the payment system. In the words of Representative Carter Glass, they "sought to tear down these tollgates upon the highways of commerce."

That's how we should think about the payment system—as the highways of commerce that support every dollar that fuels our economy. Just like roads and bridges, the payment system is critical public infrastructure—something that everyone should be able to use. We can't let profit-motivated big banks—banks whose only mission is to serve their shareholders, not ordinary Americans—have a monopoly over it.

This Committee has heard a lot this year about big corporations taking advantage of us through the smokescreen of new technology and innovation.

In our data privacy hearings, we heard about big tech companies and financial firms manipulating us into sharing our personal data so they can profit.

Facebook dodged our questions about its plans to run its own digital currency out of a Swiss bank account—showing yet again that we can't trust them.

We cannot allow big corporations to take over critical public infrastructure. The largest banks and tech companies are not acting in the interest of working Americans. Their only interest is to turn a profit for themselves and their investors.

But the Fed's interest here is not to make a profit—it's to make sure everyone can pay their bills on time and transfer money when they need it, whether they're in a rural town or a big city.

The Fed's real-time payment system will benefit working families, small banks and credit unions, small businesses, and the public as a whole—and everyone except Wall Street agrees.

Thank you, and I look forward to hearing from our witnesses.

PREPARED STATEMENT OF ESTHER GEORGE

PRESIDENT, FEDERAL RESERVE BANK OF KANSAS CITY, ON BEHALF OF THE FEDERAL RESERVE SYSTEM

SEPTEMBER 25, 2019

Chairman Crapo, Ranking Member Brown, and Members of the Committee, thank you for this opportunity.

Chair Powell has asked me to speak to you today in my role as the Federal Reserve Bank leader responsible for the Federal Reserve's payments improvement initiative since its beginning and as chair of the Financial Services Policy Committee (FSPC). The FSPC oversees the provision of payment services to depository institutions and the United States Treasury by the 12 Federal Reserve Banks. I am pleased to offer my statement for the record as well as an in-depth statement on the role of the Federal Reserve in faster payments and the recently announced proposal by the Federal Reserve to support faster payments.

Over the past decade, cell phones and other online capabilities have made it more convenient to send and receive payments. Although these mobile apps appear to provide for an immediate transaction, the underlying infrastructure is not designed to immediately move money between banks, creating notable delays between the initiation of a retail payment and its receipt.

To support the demand for real-time payments in the United States and to address this gap, last month, the Federal Reserve's Board of Governors (Board) announced that the Federal Reserve Banks would develop a new service called the FedNow Service.

Since its founding more than a century ago, the Federal Reserve has provided payment and settlement services as part of its core function of promoting an accessible, safe, and efficient payment system for the Nation. Today, the Federal Reserve is continuing this important operational role and preparing to support the modernization of our Nation's payment system with capabilities that allow payments to move quickly through a safe and efficient foundation, on top of which innovation and competition can flourish.

This decision was made only after three established criteria were met.

The first of these criteria is that it is a service that other providers alone cannot be expected to provide with reasonable effectiveness, scope and equity.

Of notable importance related to this criterion is the Federal Reserve's ability to connect to more than 10,000 financial institutions. Through these connections, the Federal Reserve's existing payment services allow banks of every size to serve the needs of thousands of communities across the United States with competitive, fair, and transparent access. Providing this degree of comprehensive nationwide reach is something that we believe will present significant challenges to other providers in the current market landscape. Coming from a region of the country with a significant number of small community banks serving rural areas of the central United States, I can tell you the Board's decision to provide this new service has been well received.

The second criterion is that there will be a clear public benefit, including promoting the integrity of the payments system and reducing payments system risk.

The Federal Reserve must continue to play an important role in promoting the safety of the U.S. payment system by providing liquidity and operational continuity in response to financial turmoil, terrorist attacks, natural disasters, and other crises. The FedNow Service will allow the Federal Reserve to retain its ability to provide stability and support to the banking system, as well as promote the development and implementation of industrywide fraud-mitigation standards. Development of the service will also enhance safety of the U.S. payment system by promoting resiliency through redundancy.

The final criterion is that the Federal Reserve be able to fully recover its cost over the long run. The U.S. payments infrastructure today includes alternative payment choices and providers. Today, the Federal Reserve and The Clearing House operate competing and interoperable services, which bring important benefits for resiliency and competition. In all of our services, we have been able to meet the requirements of the Monetary Control Act for cost recovery that ensures competitive fairness while fulfilling our public policy goals. In this regard, even as we develop the FedNow Service, the Federal Reserve will continue to explore ways to support the market's existing private-sector real-time payment service including through expanded Fedwire Funds Service and National Settlement Service hours as described in the recent *Federal Register* notice.

As was explained in a 2016 GAO study, the Federal Reserve's role as an operator has long been judged as effective in promoting accessibility, safety, and efficiency for the Nation's payment system and its customers.[1] [2] Last summer, the U.S. Treasury 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, that would also allow for more efficient and ubiquitous access to innovative payment capabilities." [3] We are engaging now with stakeholders for their input on features of the FedNow Service through the *Federal Register* notice issued last month.

Finally, I found it gratifying after the Federal Reserve started the conversation about faster payments in the U.S. and led 4 years of stakeholder engagement that culminated in the overwhelming majority of 400 comments from industry, consumer, and small business expressing support for the Federal Reserve's role as a faster payments provider.

I am confident that by working with all payment system stakeholders, we can achieve our public policy objectives for broadly accessible, safe and efficient faster payments.

Thank you. I am happy to respond to your questions.

ADDENDUM

Faster Payments and the U.S. Payment System

The U.S. payment system faces a critical juncture in its evolution. Services to conduct faster payments, which are available via smart phones apps or on our computers, have begun to emerge along with the growth of digital commerce. Faster payments allow individuals and businesses to send and receive payments within seconds, any time of day, on any day of the year, such that the receiver can use the funds almost instantly. The round-the-clock, real-time nature of faster payments offers convenience that is not available with many traditional ways of making payments. In addition, faster payments can yield real economic benefits for individuals and businesses by providing them with more flexibility to manage their money and allowing them to make time-sensitive payments whenever needed.

Yet with many of the faster payment services available today, the underlying infrastructure is not designed to immediately move money between banks, creating notable delays between the initiation of a retail payment and its receipt. These shortcomings limit the degree to which the potential benefits of faster payment services may be widely enjoyed across our economy in a safe manner. Further expansion of the interbank infrastructure is needed to serve as the foundation for the development of faster payment services that are safe, efficient, and broadly accessible to the American public.

Last month, the Federal Reserve's Board of Governors (Board) announced that the Federal Reserve Banks (Reserve Banks) would develop a new service called the FedNowSM Service to support widespread adoption of faster payments in the United States. The FedNow Service will provide the necessary infrastructure, alongside similar services provided by the private sector, to connect banks across the country, allowing them to offer innovative faster payment services to their customers.

Since its founding, the Federal Reserve has played a key operational role in the Nation's payment system by providing interbank payment infrastructure that is available to banks across the country, regardless of size or location. This critical role, given by Congress, stems from the Federal Reserve's unique ability, as the Nation's central bank, to provide interbank settlement without introducing liquidity or credit risks. In today's payment infrastructure, whether in check processing, auto-

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[1] "Federal Reserve's Competition With Other Providers Benefits Customers, but Additional Reviews Could Increase Assurance of Cost Accuracy", U.S. Government Accountability Office. August 30, 2016. *https://www.gao.gov/products/GAO-16-614*

[2] "The Federal Reserve in the Payments Mechanism", Federal Reserve System. January 1998. *https://www.federalreserve.gov/boarddocs/press/general/1998/19980105/19980105.pdf*

[3] U.S. Treasury, "A Financial System That Creates Economic Opportunity: Nonbank Financials, FinTech, and Innovation", (July 2018) at 156. Available at *https://home.treasury.gov/sites/default/files/2018-07/A-Financial-System-that-Creates-Economic-Opportunities-Nonbank-Finance.pdf.*

mated clearinghouse (ACH) services, or funds transfers, you will see a Federal Reserve service operating in healthy competition with and in support of similar services provided by the private sector, all for the benefit of the American public.

The importance of this role has been recognized broadly, with an independent review by the U.S. Government Accountability Office concluding that the Federal Reserve's provision of payment services has benefited the U.S. payment system and its users.[4] It is important to point out, however, that Congress did not grant plenary regulatory or supervisory authority over the U.S. payment system to the Federal Reserve, and the Federal Reserve does not have regulatory authority over the pricing set by a private-sector system or to require a private-sector system to extend the service to banks of all sizes. In some other countries, central banks have been assigned the responsibility for regulating payment systems. In the United States, this is not the case. Thus, the Federal Reserve has historically helped to promote the accessibility, safety, and efficiency of the Nation's payment system and advance innovations through its operational role as provider of payment and settlement services.

Path to Present

Leading up to the recent FedNow Service decision and announcement in August, the Federal Reserve took several actions to facilitate the advancement of faster payments in the United States. In 2013, the Federal Reserve began a collaborative initiative with industry stakeholders to foster improvements to the Nation's payment system. As part of this initiative, the Federal Reserve convened in 2015 the Faster Payments Task Force (FPTF), comprising a wide range of industry stakeholders, to identify and evaluate alternative approaches for implementing safe and ubiquitous faster payment capabilities in the United States.

The FPTF published in 2017 a set of consensus recommendations focused on actions to support improvements to the Nation's payment system.[5] Among the FPTF's recommendations were requests for the Federal Reserve (1) to develop a 24x7x365 settlement service to support faster payments and (2) to explore and assess the need for other Federal Reserve operational role(s) in faster payments. Subsequently, the U.S. Department of the Treasury 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, that would also allow for more efficient and ubiquitous access to innovative payment capabilities."[6]

The Federal Reserve also has directly supported the development of private-sector real-time gross settlement (RTGS) services for faster payments. The Board approved in 2017 final guidelines for evaluating requests for joint accounts at the Reserve Banks intended to facilitate settlement between and among banks participating in private-sector payment systems for faster payments.[7] The impetus for allowing broader use of joint accounts was to support these private-sector arrangements.

In November 2018, the Board published a *Federal Register* notice (2018 Notice) requesting comment on two potential actions that could be taken by the Federal Reserve consistent with the FPTF recommendations: (1) a service for 24x7x365 real-time interbank settlement of faster payments; and (2) a liquidity management tool

[4] See U.S. Government Accountability Office, GAO-16-614, "Federal Reserve's Competition With Other Providers Benefits Customers, but Additional Reviews Could Increase Assurance of Cost Accuracy" (2016). Available at *https://www.gao.gov/products/GAO-16-614.*

[5] These recommendations were intended to help achieve the FPTF's vision of ubiquitous faster payment capabilities in the United States that would allow any end user (that is, an individual or business) to safely, efficiently, and seamlessly send a faster payment to any other end user, no matter which banks or payment services they use. See Faster Payments Task Force, "Final Report Part Two: A Call to Action", (July 2017). Available at *https://fedpaymentsimprovement.org/wp-content/uploads/faster-payments-task-force-final-report-part-two.pdf.*

[6] The U.S. Department of the Treasury also noted that "[i]n particular, smaller financial institutions, like community banks and credit unions, should also have the ability to access the most-innovative technologies and payment services. While Treasury believes that a payment system led by the private sector has the potential to be at the forefront of innovation and allow for the most advanced payments system in the world, back-end Federal Reserve payment services must also be appropriately enhanced to enable innovations." U.S. Treasury, "A Financial System That Creates Economic Opportunity: Nonbank Financials, FinTech, and Innovation", (July 2018) at 156. Available at *https://home.treasury.gov/sites/default/files/2018-07/A-Financial-System-that-Creates-Economic-Opportunities-Nonbank-Financi.pdf.*

[7] Board of Governors of the Federal Reserve System, "Guidelines for Evaluating Joint Account Requests", (Issued 2017). Available at *https://www.federalreserve.gov/paymentsystems/joint__requests.htm.* In 2016, Federal Reserve staff received a request from a private-sector service provider to open a new joint account for that organization's proposed faster payment system. The use of a joint account at a Reserve Bank to support settlement mitigates certain risks by reproducing, as closely as possible, the risk-free nature of settlement in central bank money.

that would enable transfers between accounts held at Reserve Banks on a 24x7x365 basis to support services for real-time interbank settlement of faster payments.

The Board explained that a Federal Reserve RTGS service for faster payments, alongside private-sector RTGS services, would provide the infrastructure needed to achieve ubiquitous, safe, and efficient faster payments in the United States. Other parties, such as banks, payment processors, and providers of payment services, could utilize this platform as a basis for innovation to meet the specific needs of the businesses and households they serve. The Board further explained that a liquidity management tool, in turn, could help alleviate liquidity management issues for banks engaged in RTGS-based faster payments, notably those utilizing settlement services offered by the private sector. In particular, such a tool would enable movement of funds between accounts at the Reserve Banks during hours when traditional payment and settlement services are currently not open to allow liquidity to be moved, when needed, to an account or accounts used to support real-time settlement of faster payments. The 2018 Notice proposed that the tool could be provided by expanding operating hours of current Federal Reserve services or through a new service.

In the 2018 Notice, the Board requested comment on the appropriateness of real-time gross settlement as the strategic foundation for faster payments in the United States and the public benefits, implications, and challenges of the Federal Reserve taking either, both, or neither of the potential actions.

Consideration of Comments and Policy Assessment

The Board received over 400 comment letters representing over 800 entities in response to the 2018 Notice. Comments were submitted by a wide variety of stakeholders in the U.S. payment system, including community banks, individuals, consumer organizations, merchants, service providers, private-sector operators, FinTech companies, trade organizations, and other interested parties. [8] Consistent with the diversity of the payment industry, commenters represented a broad range of viewpoints.

Almost all commenters addressed the question of whether the Federal Reserve should develop a real-time interbank settlement service for faster payments. The vast majority of these commenters, representing nearly every stakeholder segment, supported the Federal Reserve taking this action. In contrast, large banks, some trade organizations, and private-sector operators were generally not supportive of the Federal Reserve developing such a service. [9]

In reaching its decision to offer the FedNow Service, the Board was informed by these public comments and the history of the U.S. payment system, in which the Federal Reserve has played a role since its inception. In addition, any decision by the Board to offer a new payment service is subject to the factors set out in longstanding Federal Reserve policy, and the pricing of Reserve Bank services is subject to the requirements of the Monetary Control Act of 1980. [10] Specifically, in considering new services, the Board assesses three criteria: whether the service is one that other providers alone cannot be expected to provide with reasonable effectiveness, scope, and equity; whether the service will yield a clear public benefit; and whether the Federal Reserve will achieve full cost recovery over the long run. [11]

Other Providers Criterion

Through this assessment, the Board has concluded that other providers alone cannot be expected to provide an RTGS infrastructure for faster payments with reasonable effectiveness, scope, and equity. So far, only one private-sector RTGS service for faster payments has been established in the United States. Due to coordination challenges and the high fixed costs necessary to develop a new payment and settlement service, this service is expected to remain the sole private-sector RTGS service for faster payments in the United States. The ability of a sole private-sector provider to extend access to a few thousand banks, let alone the more than 10,000 di-

[8] Overall, banks were the largest group of respondents, with community banks (small and midsize banks) comprising approximately 60 percent of the total comments—the largest specific segment—and representing institutions from 34 States.

[9] Approximately half of the commenters discussed the liquidity management tool, with almost all supporting the Federal Reserve offering such a tool.

[10] In 1984, the Board established criteria for the consideration of new or enhanced Federal Reserve payment services in its policy "The Federal Reserve in the Payment System". Board of Governors of the Federal Reserve System, "The Federal Reserve in the Payment System", (Issued 1984; revised 1990). Available at *https://www.federalreserve.gov/paymentsystems/pfs_frpaysys.htm.*

[11] In addition, the Board performs a competitive impact analysis when considering an operational or legal change to a Reserve Bank service or price that would have a direct and material adverse effect on the ability of other providers of services to compete with the Reserve Banks.

verse banks necessary to achieve true nationwide scope, would be costly and time-consuming given that the existing service has limited relationships with and connections to these institutions.

In addition, the Board concluded that the private-sector operator alone cannot be expected to provide the service with reasonable effectiveness, as viewed through the lenses of safety and efficiency. From a safety perspective, a sole provider may serve as a single point of failure in the market for RTGS-based faster payments. From an efficiency perspective, a market with only a single operator may cause challenges related to competition, innovation, and market fragmentation. According to established economic theory and experience from other markets, a single service provider not facing competition can yield undesirable outcomes, such as higher prices or lower service quality. Such undesirable outcomes could limit adoption of faster payments by end users, which could in turn curtail efficiency benefits to the broader economy.

Public Benefits Criterion

The Board also determined that the FedNow Service will yield a clear public benefit. Since its inception, an underlying public policy rationale for the Federal Reserve's involvement in the payment system has been to provide services in a safe and efficient manner to banks nationwide. Because of this long-standing policy commitment, the Federal Reserve has historically extended access to banks of all sizes, including smaller banks in rural and remote areas of the country. The Federal Reserve's relationships with and connections to thousands of banks across the country provide a solid foundation for the FedNow Service to facilitate those banks gaining access to an RTGS infrastructure for faster payments, which would benefit small and midsize banks and the communities they serve.

In a payment system with multiple operators, banks would have a choice whether to join a single service or multiple services. An RTGS infrastructure could, therefore, achieve nationwide reach in two main ways, either through interoperability via direct exchange of payments between operators, such as in the U.S. ACH system, or through at least one service connecting to virtually all banks, such as in the funds transfer system.

The FedNow Service would promote payment system safety in multiple ways. As noted by commenters, the Federal Reserve has historically played an important role in promoting the safety of the U.S. payment system by providing liquidity and operational continuity in response to financial turmoil, terrorist attacks, natural disasters, and other crises. As the prominence of faster payments in the United States grows, the development of the FedNow Service would allow the Federal Reserve to retain its ability to provide stability and support to the banking system and the broader economy in times of crisis. In addition, as the operator of the service, the Federal Reserve would be in a position to promote the development and implementation of industrywide fraud-mitigation standards, which commenters highlighted are especially important for real-time payments. The development of the service could also enhance the safety of the U.S. payment system by promoting resiliency through redundancy.

Finally, the FedNow Service could provide efficiency benefits by serving as a platform for innovation and the development of end-user services by the private sector. In addition, an RTGS infrastructure with nationwide reach would make the development of new faster payment services based on real-time settlement more attractive, increasing innovation and competition in the market for end-user faster payment services. Such competition could yield efficiency benefits by leading to lower prices and higher service quality.

Cost Recovery Criterion

The Board expects that the FedNow Service will achieve full recovery of costs over the long run. The MCA requirement to require cost recovery "over the long run" is not associated with a specific timeframe. Beginning in 1995, the Board adopted a convention of evaluating long-run cost recovery for existing services using a rolling 10-year period. At that time, Federal Reserve services were in mature states, characterized by widespread adoption by banks of all sizes throughout the country, with relatively stable volumes and costs. At other times, notably as the ACH service was evolving, the Board considered long run over an extended time period in order to encourage the adoption of electronic payments for the benefit of the economy. [12]

[12] ACH began as a Federal Reserve service in the 1970s, prior to the passage of the MCA. 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 and only at the end of that time began marking 10-

Given the timeframe necessary to create a broad network of banks connecting to the service, the Board determined that a longer timeframe for cost recovery is consistent with the intent of the MCA to encourage the adoption of new services that have the potential to bring widespread economic benefits to the country.

Expanded Hours for Existing Services

The second proposed action in the 2018 Notice entailed the exploration of the expansion of operating hours for the Fedwire Funds Service, which is our existing funds transfer service, and National Settlement Service (NSS) hours, which is our service that supports private-sector net settlement arrangements, potentially up to 24x7x365, to facilitate liquidity management, notably for users of private-sector RTGS services.

As described in the 2018 Notice, RTGS-based faster payment services require banks to have sufficient liquidity positioned in a specified account to perform interbank settlement at any time, on any day. Without sufficient liquidity so available to conduct settlement, a faster payment cannot be completed in an RTGS-based service where, by design, interbank settlement occurs before final funds can be made available to the receiver. At present, the Federal Reserve does not provide a service that would provide a means to position additional liquidity in the specified account outside standard business hours. In light of these considerations, in its 2018 Notice the Board proposed developing a liquidity management tool that could help address these needs by facilitating transfers to and from other accounts held by participants at Federal Reserve Banks.

In response to the 2018 Notice, several large banks and other commenters indicated that the proposed tool could help with managing liquidity in the recently established private-sector RTGS service for faster payments. The private-sector RTGS service is supported by funds in a joint account at a Reserve Bank, and the proposed liquidity management tool would enable movement of funds between a joint account and banks' reserve accounts during hours when existing services are not currently open. Commenters suggested that the Federal Reserve should provide this tool through expansion of operating hours for the Fedwire Funds Service.

Commenters also noted that expanded Fedwire Funds Service hours, and relatedly, NSS hours, could provide benefits for a variety of payment activities beyond those related to faster payments. Payment activity supported by expanded hours could include additional settlement windows for the ACH service and wholesale payment activity in global markets. Because of the systemic importance of the Fedwire Funds Service, in particular, additional risk, operational, and policy analysis is required for this action, and the draft notice indicates the Federal Reserve's intention to engage actively with the industry to conduct this analysis.

The FedNow Service

As explained in the August announcement, the FedNow Service would conduct real-time, payment-by-payment, settlement of interbank obligations through debits and credits to banks' balances in accounts at the Reserve Banks. Real-time settlement in accounts at the Reserve Banks means that settlement occurs without liquidity or credit risks, which enhances the safety of these payments. The FedNow Service would incorporate clearing functionality, allowing banks, in the process of settling each payment, to exchange information needed to make debits and credits to the accounts of their customers. The service's functionality would support banks' (or their agents') provision of end-to-end faster payments to their customers.

Ultimately, the FedNow Service will provide, alongside similar private-sector services, core infrastructure to promote ubiquitous, safe, and efficient faster payments in the United States. In fact, for all payment systems in our country, no single private-sector provider has ever achieved nationwide reach on its own. With the FedNow Service, banks will now have a choice in providers or could choose to use both a Federal Reserve and private-sector service for back-up purposes, as some do today for check, ACH, and wire services.

The Federal Reserve recognizes that time-to-market is an important consideration expressed by many commenters in response to the 2018 Notice. Our objective is to implement the service as soon as practicably possible. However, the achievement of true nationwide reach over the long term, as opposed to initial availability of a service, is the most important measure of success for faster payments.

At the same time as the Board published its decision regarding the new service, the Board requested public comment on how the FedNow Service might be designed to most effectively support the full set of payment system stakeholders and the func-

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year cost recovery. The Board concluded that doing so would result in a more efficient payment mechanism and was consistent with the MCA. See 46 FR 1343 (January 6, 1981).

tioning of the broader U.S. payment system. In the same notice, the Board also announced its intention to explore the expansion of Fedwire Funds Service and NSS hours, up to 24x7x365, to facilitate liquidity management in private-sector real-time gross settlement services for faster payments and to support a wide range of payment activities, beyond those related to faster payments.

The Board's important decision to approve a new payment service comes over 40 years after the last service, ACH, was approved for implementation back in the 1970s. The decision to establish ACH came at a pivotal moment when the industry was overwhelmed by the volume of paper checks, and the new technology at that time allowed for what is essentially an electronic version of paper checks. Remarkable new technology enables the Federal Reserve to support the financial sector in offering an ever-growing array of options 24x7x365 in a safe and efficient manner. Providing such payment services is very much consistent with our historical role in the payment system, one that has helped banks to meet the needs of business and households in a growing economy for over a century.

PREPARED STATEMENT OF ROBERT HUNTER

EXECUTIVE MANAGING DIRECTOR AND DEPUTY GENERAL COUNSEL, THE CLEARING HOUSE PAYMENTS COMPANY

SEPTEMBER 25, 2019

Chairman Crapo, Ranking Member Brown, and distinguished Members of the Committee, my name is Rob Hunter, and I serve as the Deputy General Counsel of The Clearing House Payments Company, based in our North Carolina facilities. I have worked at The Clearing House for more than 10 years providing senior legal support to all of our payments services. Today, we will be focused on the RTP network, which I was fortunate to be involved in developing. I am also the past Chairman of the Subcommittee on Electronic Payments of the Business Law Section of the American Bar Association and have been involved in a host of development activities related to payments throughout my career.

The RTP network is a new and exciting part of our national payment infrastructure. It was launched in 2017 by The Clearing House and is fully operational today. One of the most distinguishing features of the RTP network is that it operates in real time and all the time—there are no "bankers' hours" for the RTP network—it functions 24x7. But that is just one remarkable feature. The RTP network also delivers on the vision of faster, more efficient and more secure payments that will benefit every American consumer and business.

This innovation is consistent with The Clearing House's historical role in delivering to our country core payments infrastructure that is efficient, safe, and reliable. Founded in 1853, for over a century-and-a-half The Clearing House has served as the leading private-sector operator of payments infrastructure in the United States. On an average business day, The Clearing House clears and settles nearly $2 trillion over its wire, automated clearing house and check-clearing networks.

The Committee has asked those of us testifying today to focus on five main issues: (a) the current state and evolution of the U.S. payment system and how the current system works, (b) the Federal Reserve Faster Payments Task Force's process, conclusions, and recommendations, (c) the Federal Reserve's notice and request for comments on its actions to support interbank settlement of faster payments through the development of the FedNow system and expanded operating hours for the Fedwire Funds Service and National Settlement Service, (d) an in-depth overview of the RTP network and any similarities to or differences from the proposed FedNow service, and (e) whether FedNow and a private-sector real-time payment system, such as the RTP network, could achieve interoperability, while ensuring efficient, safe and ubiquitous faster payments.

I will address each topic in accordance with the Committee's request, but before responding specifically to those questions, it may be helpful to provide a summary of The Clearing House's position. When the Federal Reserve competes with the private sector, the Federal Reserve must do so in a manner that minimizes the competitive advantages that a Government system has, both inherently and as a direct byproduct of the Federal Reserve's role as a supervisor, the supplier of liquidity to the financial system and the central bank. This is not the normal competitive question of impact on profitability because The Clearing House does not seek to operate at a profit. Rather, it is a question of The Clearing House's ability to provide the most effective and efficient real-time payment system to consumers and businesses, to the ultimate benefit of this country's overall economy.

Current State and Evolution of the Payment System

The payments landscape in the United States is complex and highly competitive, with tremendous innovation during the last decade spurred by banks, money services businesses and FinTechs. This innovation has largely been focused on end-user products. What has been lacking, however, until the launch of the RTP network, is modernization of what we often refer to as the payments rails. This lack of modernization has had important consequences. Consumers and businesses have been left to choose between payments options that were slower than desired and that offered conditional forms of payment, or new payment products that sit outside of the traditional banking system, often with less security and resiliency. Bank and nonbank financial institutions have been forced to accept settlement risk, increasing fraud risk and increased operational complexities due to limitations in the underlying payment rails. The RTP network, the first new payments rail in over 40 years, is designed to eliminate these suboptimal choices and risks, to accelerate the availability of payments, and to serve as a platform for innovation for all.

Americans don't spend a lot of time thinking about our country's payments system, which is understandable because so much of it is hidden from view. But make no mistake—without this infrastructure our economy would cease to function. Our payments system enables consumers and businesses to make payments safely, securely and with certainty—whether you are paying your wireless bill or splitting a restaurant tab with friends.

Although the U.S. payments system has and continues to work very well (meaning safely and efficiently), prior to the introduction of the RTP network, it had become (as noted above) very outdated when compared to the payments systems in other industrialized parts of the world. I suspect everyone in this room has been frustrated upon hearing that you have to wait a day or longer to gain access to funds you have received or when you don't actually know when a party to whom you have made a payment will actually receive those funds. These frustrations are due to the simple fact that our country's payments infrastructure was designed and built over 40 years ago—well before the dawn of the Internet and mobile phones.

Launched in November of 2017 and fully operational, the RTP network addresses the need to modernize the payments infrastructure in the United States and provides a safer, more secure and more efficient way to make payments that clear and settle immediately, consistent with the way American consumers and businesses operate today.

Federal Reserve Faster Payments Task Force

To its credit, the Federal Reserve recognized the need for faster payments in the United States and leveraged its convening power to urge the private sector to act. In 2013, the Federal Reserve proposed 5 objectives to improve the U.S. payment system that, according to the Federal Reserve, would ideally be achieved within 10 years, including "[a] ubiquitous, safe, faster electronic solution(s) for making a broad variety of business and personal payments supported by a flexible and cost-effective means for payment clearing and settlement groups to settle their positions rapidly and with finality" (i.e., a real-time payments system).[1]

After receiving substantial stakeholder comment on the various objectives, including commentary expressly directed toward the development of a real-time payments system, the Federal Reserve published in 2015 its Strategies for Improving the U.S. Payment System.[2] In this paper, the Federal Reserve described various strategies for improving the payments system in the United States, including "[i]dentify[ing] effective approach(es) for implementing a safe, ubiquitous, faster payments capability in the United States", noting that "[p]ayment stakeholders will ultimately determine through their individual and collective actions the extent to which these strategies are achieved."[3]

In late 2015 and early 2016 and to further the strategies outlined in its 2015 paper, the Federal Reserve established its Faster Payments Task Force (FPTF), which was charged with "evaluating options for achieving faster payments capabilities with the goal of identifying the approach(es) that would best achieve the desired outcomes."[4] As part of this assessment process, the FPTF called on the private sec-

[1] "Payment System Improvement—Public Consultation Paper" (Sept. 10, 2013), available at *https://fedpaymentsimprovement.org/wp-content/uploads/2013/09/Payment-System-Improvement-Public-Consultation-Paper.pdf.*

[2] Strategies for Improving the U.S. Payments System (Jan. 26, 2015) available at *https://fedpaymentsimprovement.org/wp-content/uploads/strategies-improving-us-payment-system.pdf.*

[3] Id. at 3.

[4] Id. at 17.

tor to submit proposals for "a full end-to-end payments solution" to achieve the identified strategies.[5] These proposals were to be judged against the "effectiveness criteria" developed by the FPTF to determine "how well solutions can achieve the desired outcomes associated with improving the U.S. Payments System."[6]

Of the 16 different private-sector proposals that were submitted to the FPTF, The Clearing House's RTP network proposal received the very highest marks, achieving a rating of "very effective" (the highest possible rating) with respect to 31 of the 36 criteria and "effective" with respect to the remaining five.[7] A "very effective" rating meant that "the solution fully satisfies the[] criteria."[8]

Importantly, the RTP network was given the highest rating possible with respect to its plan to achieve ubiquity, its approach to settlement and resiliency as well as the other categories noted below:

Attribute	Federal Reserve FPTF Rating ("Very Effective" is highest possible)
Accessibility (plan to achieve ubiquity)[ix]	Very Effective
Enables Competition	Very Effective
Implementation Timeline	Very Effective
Risk Management	Very Effective
Payment Finality	Very Effective
Settlement Approach	Very Effective
Fraud Information Sharing	Very Effective
Security Controls	Very Effective
Resiliency	Very Effective
Fast Settlement	Very Effective
Consumer Protections	Very Effective
Effective Governance	Very Effective

The Clearing House was well positioned to meet the need identified by the Federal Reserve for the development of a real-time payments solution and is proud of the ratings its solution received from the FPTF.

That The Clearing House would be well-positioned to deliver on the promise of faster payments for all should not come as a surprise. The Clearing House, which was created to provide the payment services required by the Nation's economy, has been in existence for over 165 years and, while owned by a relatively small number of banks, it has always existed to serve depository institutions of all sizes, and continues to do so today. In fact, in The Clearing House's Automated Clearing House (ACH) and check-clearing networks approximately 80 percent of our customers are banks and credit unions with $10 billion in total assets or less.

The Clearing House has been entrusted with operating an integral part of the financial system since 1853 because we serve our participants effectively and ethically. We do not engage in anti-competitive behavior because such behavior offends our culture and core values. Our focus on the needs of the industry as a whole has

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[5] "In Pursuit of a Better Payment System", Federal Reserve Banks (2016) at 5.

[6] Id. at 4.

[7] Faster Payments QIAT Assessment (Feb. 21, 2017).

[8] Faster Payments Effectiveness Criteria (Jan. 26, 2016) (FPTF Effectiveness Criteria) at 6.

[9] "Accessibility" is defined in the FPTF Effectiveness Criteria as meaning that the solution would "enable any entity . . . to initiate and/or receive payments to/from any Entity" and that the solution had a "credible plan for achieving widespread adoption." FPTF Effectiveness Criteria at 6.

led The Clearing House to price our services on a "cost recovery basis"—in other words, services are priced at a level sufficient to maintain the ongoing safety and soundness of The Clearing House's systems and to make necessary investments in research and development. The Clearing House doesn't have shareholders seeking to maximize profits: it has never paid a dividend in its history, there is no expectation for any return on capital and there is no special pricing for owner banks. The Clearing House instead annually reassesses fees; this cost recovery model has enabled The Clearing House to continually lower prices over time. And, if that were not enough, we are subject to antitrust laws that provide real guardrails on the way we compete, and to multiple different legal protections that prohibit unfair or deceptive acts and practices.

The Clearing House maintains a critical and constant emphasis on the safety, security, reliability, and efficiency of its payment systems and it has a remarkable 166-year history of resiliency, having maintained its operations without interruption through multiple world wars, financial crises and natural and man-made disasters, including 9/11 and the great recession.

The RTP Network

To meet the needs identified by the Federal Reserve and consistent with the criteria articulated by the FPTF, The Clearing House led an initiative to modernize the U.S. payments system by developing the RTP network. Today, the network represents the culmination of The Clearing House and the private sector's collective investment of more than $1 billion to design, build, launch, and commercialize a real-time payments network in this country. Launched in 2017 and fully operational since that time, the RTP network is the first significant new payments infrastructure introduced in the United States in over 40 years. The RTP network was designed and built to offer real-time payments capabilities to every consumer and business in the country via any and all depository institutions nationwide that want to deliver this functionality to their customers—what the industry refers to as "ubiquity". This means that whether you bank with JPMorgan Chase, or the community Bank of Oak Ridge, North Carolina, where I live, any consumer or business can have the benefits of real-time payments through their depository institution. Today, the RTP network is already connected to over 50 percent of all U.S. transaction accounts, with the goal of achieving near-universal reach in the next several years.

In terms of the network's functionality, RTP delivers the real-time capabilities that Americans want and need, so that payment recipients receive final, good funds immediately and senders receive confirmation that the funds have been received. The benefits to consumers, small businesses, and the Nation's economy are transformational. For example:

- Employees who were previously paid by check can be paid through the RTP system and have immediate access to final good funds;
- Day laborers can be paid immediately at the end of their shift;
- Uber drivers can get money into their bank accounts to buy gas for the next day;
- Consumers can stop worrying about how long a payment may take to get to their power company, their mortgage lender or their water company;
- Small businesses, like contractors, can be paid immediately upon completion of a job;
- Restaurants can leverage the RTP network to make payments for "just-in-time" inventory instead of relying on credit; and
- Insurance companies can get disaster relief funds immediately into their policyholders' accounts.

While the immediacy of a payment is an important component of the RTP network, RTP offers so much more, including the rich data features of the system, which allow small businesses to easily transmit invoices and instantly receive payments—streamlining cashflow for businesses that are the backbone of our economy. In addition to the examples above, the appended Fact Sheet provides more details on the design of the RTP network.

In addition to the features of the RTP network that will provide all Americans with a range of new benefits relating to speed, convenience, and safety of the payments they make and receive, there are also societal benefits that will accrue from real-time payments. Some analysts, for instance, believe that real-time payments are one of the most immediate ways to benefit Americans who today live paycheck-to-paycheck but tomorrow can receive immediate, final payment through the RTP system and therefore have earlier access to funds.

Let me briefly talk about achieving near-universal reach for the RTP network. The RTP network was designed and built so that the network has the capacity to reach every depository institution in the country, either directly or through third-party service providers, so that every American consumer and business can have the benefit of real-time payments. To achieve this, The Clearing House not only built out the technical capabilities to reach the country's 11,000 financial institutions, but also ensured that the pricing to participate on the network was the same for all banks and credit unions regardless of size. In sum, whether you are the country's largest commercial bank or the smallest, you pay the same, per-transaction fee, to bring these capabilities to your customers.

But the decision by a bank to join a faster payments network like the RTP network or, in 4 years, FedNow, is not simply a matter of having a preexisting connection or paying the per-transaction fee.[10] Each bank joining a faster payments network needs the right connection, one that is highly resilient (persistent) and right sized for the nature of real-time payments, needs a back office with the capacity and technology to accomplish real-time accounting and availability and needs employee resources available for 24/7 payments support. This is a heavy lift for all banks and for most requires the assistance of third party service providers. The Clearing House has been working with all types of service providers to help ensure that true access to the RTP network is within reach.

The RTP network is also a fundamentally safer and more secure way to pay. RTP payments are limited to "credit push" only, which means that consumers are always in control of the money that moves from their accounts. Unlike "debit pull" systems, where a payee can pull money from an account, consumers and businesses using the RTP network must authenticate into their bank's platform and affirmatively send or "push" money to a recipient—no one can "pull" money out. This feature also lays the foundation for securing the message between the bank and its customer, responding to the need for greater fraud resistance and better cybersecurity.

Federal Reserve Notice and Request for Comment on Actions To Support Interbank Settlement

The Committee has explicitly requested our views about the Federal Reserve's decision to enter the real-time payments playing field. Less than a year after the RTP network went live, the Federal Reserve issued a proposal that contemplated entering the market with its own competing real-time gross settlement (RTGS) system.[11] (The RTP network is also a real-time gross settlement system.) In this proposal, the Federal Reserve cited, as a major justification for potential entry, a generalized concern that its real-time payment service would be needed to achieve the ubiquity that could not be achieved by the private sector.[12] There was no analysis of The Clearing House's then-operational RTP network's efforts to achieve ubiquity or the FPTF findings related to the RTP network.

The 2018 proposal had two other important components. First, the Federal Reserve noted that accessibility would be greatly enhanced "if existing and potential future private-sector RTGS services were able to interoperate with a Reserve Bank service such that end-user customers of any bank could send faster payments to end-user customers of any other bank regardless of the faster-payments services used by the banks."[13] Second, the Federal Reserve suggested that it might modernize its own existing Fedwire and National Settlement Service (NSS) infrastructures, upon which the private sector relies to manage liquidity, by extending the hours of those services to meet the demands of a 24x7 economy. The comment process revealed near unanimity of support for extending Fedwire and NSS hours.[14]

While The Clearing House was disappointed in the Federal Reserve's action suggesting it might enter the market with its own solution, and concerned over the chilling impact that might have on The Clearing House's plans to bring the benefits of real-time payments to every American, The Clearing House was also encouraged by statements that the Federal Reserve might modernize its own existing Fedwire and NSS infrastructures. If the Federal Reserve took these enhancing actions, pri-

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[10] The Federal Reserve makes a similar observation in its *Federal Register* notice where it notes that FedNow participants "would need to deploy and test enhanced or upgraded FedLine components" and "maintain adequate telecommunications services to support the expected end-to-end speed of payments." Federal Reserve Actions To Support Interbank Settlement of Faster Payments, 84 FR 39297, 39320 (Aug. 9, 2019).

[11] Potential Federal Reserve Actions to Support Interbank Settlement of Faster Payments, Request for Comments, 83 FR 57351 (Nov. 15, 2018).

[12] Id. at 57361.

[13] Id.

[14] 84 FR 39297, 39302 (approximately 225 of 230 commenters supported the Federal Reserve's liquidity management proposal).

vate-sector systems would find it easier to offer 24x7 payments services, which currently operate during times when the Federal Reserve is not open or operational to provide liquidity.

In August of 2019, the Federal Reserve issued a *Federal Register* notice stating that it would enter the market with its own competing RTGS system, FedNow. The Federal Reserve acknowledged that FedNow would not be ready to launch until 2023 or 2024 at the earliest and that nationwide reach would take more time to establish.[15] In spite of near unanimity of support for extending Fedwire and NSS hours, the notice states only that the Federal Reserve will continue to "explore the expansion" of Fedwire and NSS hours.[16]

The announcement stated that the Federal Reserve's FedNow service will provide a "clear public benefit" based on accessibility, safety, and efficiency. Notwithstanding the FPTF ratings for the RTP network, the announcement also concluded that the RTGS service is not one that other providers alone can provide with "reasonable scope, effectiveness, and equity."[17] In reaching its decision, the Federal Reserve stated that the criteria "require[] a forward-looking evaluation of the probable or likely future state of the payment system over the long run, with or without Federal Reserve action" and that the Federal Reserve "focuses on expected, long-term outcomes and does not require a determination that each of the criteria is satisfied at present or will be with certainty in the future."[18]

The future state described by the Federal Reserve in its *Federal Register* notice was one in which The Clearing House would act in ways that are entirely inconsistent with its 166 year history (i.e., that we would abandon cost-recovery pricing and instead pursue a profit motive) and that in some cases would be anticompetitive despite The Clearing House being subject to antitrust laws. While unintended, the assumptions that the Federal Reserve made in support of its decision to enter the market have contributed to misinformation about The Clearing House and the RTP network and run the risk of impeding The Clearing House's ability to bring the benefits of real-time payments to every American.

The FedNow announcement further noted that the Federal Reserve believes it needs to enter the market with its own competing system because it lacks "plenary regulatory or supervisory authority" over payments systems and instead has "traditionally influenced retail payment markets through its role as an operator."[19] Its authority over The Clearing House under the Bank Service Company Act,[20] however, is extremely broad, with The Clearing House being subject to regulation and examination to the same extent as if the services being provided were being performed by the depository institution that is subject to Federal Reserve supervision itself.[21] In addition, the Act gives the Federal Reserve broad authority to issue "such regulations and orders as may be necessary to enable [it] to administer and to carry out the purposes of this [Act]."[22] Nevertheless, the Federal Reserve concludes in the *Federal Register* notice that this authority is not sufficient to protect against potential future bad behavior by The Clearing House although this conclusion is made without reference to antitrust and unfair and deceptive practices laws to which The Clearing House is subject.

Despite concerns that the Federal Reserve's announcement may hinder The Clearing House in achieving the full potential of the RTP network (see discussion below on the impact of two noninteroperable systems), The Clearing House is resolute in its goal of bringing real-time payments to the United States and believes strongly in the value and integrity of the RTP network, as fully confirmed by the strong rat-

[15] Id. at 39301.

[16] Id. at 39316.

[17] Id. at 39306–39309, 39310–39312.

[18] Id. at 39303.

[19] Id. at 39300.

[20] The Clearing House is also a designated financial market utility under Title VIII of Dodd–Frank, subjecting The Clearing House to the highest levels of supervision and regulation by the Federal Reserve. While The Clearing House's regulation and supervision under Title VIII relate specifically to its role as the operator of CHIPS, The Clearing House operates as a single entity in the operation of its payments systems.

[21] See, e.g., 12 U.S.C. §1867(c) ("[W]henever a depository institution that is regularly examined by an appropriate Federal banking agency, or any subsidiary or affiliate of such a depository institution that is subject to examination by that agency, causes to be performed for itself, by contract or otherwise, any services authorized under this chapter, whether on or off its premises . . . such performance shall be subject to regulation and examination by such agency to the same extent as if such services were being performed by the depository institution itself on its own premises . . . .").

[22] 12 U.S.C. §1867(d) ("The Board and the appropriate Federal banking agencies are authorized to issue such regulations and orders as may be necessary to enable them to administer and to carry out the purposes of this chapter . . . .").

ings it received from the Federal Reserve's own Faster Payments Task Force. We are committed to working closely with every financial institution that is interested in pursuing participation in the RTP network so that each institution's customers can obtain the benefits of real-time payments.

Comparison of the RTP Network to FedNow

The Committee has asked for a comparison of the RTP network to FedNow, which is not easy because one payment system exists and the other is an aspirational future system. The information that we have about the design of FedNow is strictly based on the *Federal Register* notice, which does not provide many significant details and suggests that much of the design of the system is still in the planning stage. While President George is best positioned to speak to the design of FedNow, we believe that the proposed design will be similar to the RTP network in the following ways.

- Both the RTP network and FedNow are real-time gross settlement systems
- Both are credit push systems that operate 24x7
- The RTP network has a current value limit of $25,000 and the Federal Reserve has indicated FedNow will have a value limit of $25,000
- Both systems will leverage ISO 20022 message standards

Of course the biggest difference between the two systems is that the RTP network is operational and available in the market today while FedNow will not be available for at least 4 years. While much has been made about differences in settlement, the RTP network uses a settlement model that has been used for decades to settle payments over The Clearing House's wire payments system, known as CHIPS, a systemically important payment system designated as such under Dodd–Frank and supervised and regulated by the Federal Reserve. RTP settlement is fully supported by a balance in an account at the Federal Reserve Bank of New York. Funding (or lack of funding) by any one RTP participant does not affect the ability of other participants to send or receive funds over the RTP network. Importantly, the RTP network is designed so that neither The Clearing House nor its participants experience credit risk. In contrast it appears that the FedNow service will provide unlimited credit (no real-time monitoring of credit positions) even on weekends and holidays when the Federal Reserve's discount window is closed.

The general design of FedNow raises several significant competitive issues for the private sector that may hamper the private sector's ability to bring the full benefits of real-time payments to consumers and businesses in this country. The good news is that the Federal Reserve could take steps to address these concerns.

First, the Federal Reserve, as the Nation's central bank, has the ability to clear and settle payments directly through financial institutions' master accounts, which means the balances being held in accounts used for FedNow payments will count towards a financial institution's reserve requirements and bear interest. The Federal Reserve has the legal authority and operational capacity to accord the same treatment to financial institution positions in the RTP account that is held at the Federal Reserve Bank of New York and that is used to facilitate RTP settlement, but so far has been unwilling to do so.

Second, given the near unanimity of support in response to its October 2018 Request for Comment that the Federal Reserve should move forward with making Fedwire and NSS available on a 24x7 basis, the Federal Reserve should act quickly to implement expanded hours. Because the private sector is dependent on Fedwire or NSS to manage liquidity in private-sector systems, this is the single most important action the Federal Reserve could take to encourage private-sector competition in real-time payments. This is especially important from a competitive perspective given that the Federal Reserve appears to have announced that it will provide unlimited access to liquidity in the FedNow system even when the discount window is closed.

These two issues must be expeditiously addressed by the Federal Reserve in order to ensure that the private sector is not impeded in its ability to bring the benefits of real-time payments to American consumers and businesses.

Finally, while the Federal Reserve's analysis of its pricing flexibility under the Monetary Control Act (MCA) comports with our understanding of the MCA, the Federal Reserve's choices on pricing will obviously significantly impact competition with the private sector. For example, the Federal Reserve has indicated that it may be 15+ years before FedNow achieves cost recovery and that initial fees will be based on "mature volumes" with the Federal Reserve anticipating that FedNow will become the sole RTGS system with "nationwide reach"[23] To ensure fair competition, The Clearing House would urge that the Federal Reserve reassess what is meant by "in the long run" to take into account the length of time that a private-sector entity would be able to wait to recover its operating costs, and calculate "mature volumes" in a manner that does not unrealistically assume volume moving away from the RTP network and to FedNow.

Interoperability

The Clearing House does not believe that interoperability between two RTGS systems is achievable. The Federal Reserve's original proposal in November of 2018 assumed that the Federal Reserve's RTGS system would be interoperable with private-sector systems. It appears from the Federal Reserve's notice, however, that the Federal Reserve has realized that interoperability is unlikely.

The result in the United States may be a completely bifurcated market, where, unless each bank in the country joins two systems (a highly expensive and inefficient proposition, particularly for smaller banks), the banks and their customers that are transmitting payments on one system will not be able to reach the banks and their customers that are on the other. In the place of ubiquity, we will have balkanization. In our view, that is a highly damaging result for the future of real-time payments in the United States.

When considering the issue of interoperability, it is important to understand the differences between real-time payments and other payment methods, such as the ACH system or wire systems like CHIPS and Fedwire. With regard to ACH, ACH is interoperable with respect to the exchange of payment messages (known as "clearing"), allowing a participant on one system to send a message to a participant on another system. It is not, however, interoperable with respect to settlement. Clearing interoperability is achievable in the ACH network because clearing and settlement in the ACH are distinct actions that happen at different times. With real-time clearing and settlement systems like the RTP network, clearing and settlement happen instantaneously—they cannot be split without significantly compromising the integrity and functionality of the system—and unlike the ACH network funds are immediately available to the recipient and are final and irrevocable.

Similarly, real-time payments cannot function like wire payments, which rely on a system of intermediary banks to be able to reach all endpoints. In contrast to systems like Fedwire and CHIPS (The Clearing House's wire system), an overarching design principle of real-time payment systems like the RTP network is to ensure that when a payer (the sender of a payment) instructs payment to a payee (the recipient of a payment), that payment will be completed instantaneously. To achieve this goal, payment systems like the RTP network must be designed so that payment processing will always be completed (meaning get to the recipient's bank) and will be completed within milliseconds. While The Clearing House has yet to see how the Federal Reserve will design FedNow to meet this important objective of real-time payments, the RTP network accomplishes this by supporting a very simple payment model. In an RTP payment there is a payer, the payer's bank, the payee and the payee's bank (no intermediary banks). This design eliminates the very real possibilities that exist today in wire transfer systems that a payment will be delayed or stopped at an intermediary bank. This also means that the RTP network can only be used to make a payment if the financial institutions holding the payer's and payee's accounts are both participants on the RTP network. This is in stark contrast to wire transfer systems like CHIPS which can be used to support payments sent by anyone to anyone regardless of whether such persons have accounts with CHIPS participants. This important distinction between wire and real-time systems like the RTP network means that CHIPS can compete with Fedwire for each and every dollar wire payment—either system could be used to help make such payments even though neither CHIPS nor Fedwire[24] is ubiquitous. The RTP network (and the FedNow service) will not enjoy that same opportunity and instead will be strictly limited to the accounts held at banks that have signed up to use the service. It is The Clearing House's view that in that type of payments environment, given the commodity nature of payments, it will be very hard for two systems to both succeed.

[23] 84 FR 39297, 39313–39314, and 39320.

[24] The CHIPS system has 44 financial institution participants. The Fedwire Funds Service has approximately 5,300 participants. (cite Fed PFMI *https://frbservices.org/assets/financial-services/wires/funds-service-disclosure.pdf* p. 8 says over 5,300 and our public website *https://www.theclearinghouse.org/-/media/new/tch/documents/payment-systems/chips-participants-revised-05-15-2019.pdf.*) Yet both systems can facilitate payments involving all 11,000 U.S. financial institutions.

Conclusion

The Clearing House is extremely proud of its record of providing essential payments infrastructure for the U.S. financial system for well over a century-and-a-half. While we are proud of our long service to the Nation, we are also excited about our country now having the most advanced payment system in the world. We are working hard to bring the benefits of the RTP network to all of the banks in this country so that your constituents, consumers and businesses across America, can all realize the benefits of faster, more efficient and more secure real-time payments.

The Clearing House appreciates your interest in this topic and I look forward to answering your questions.

The RTP Network

The Clearing House launched the RTP network in November 2017 to bring real-time payments to the United States. Today the RTP network reaches over 50 percent of U.S. transaction accounts, with a path to achieving universal adoption over the coming years. The RTP network was built for financial institutions of all sizes and serves as a platform for innovation enabling the delivery of new products and services to their customers. Real-time payments over the RTP network provide consumers and businesses with the ability to conveniently send payments directly from their accounts 24/7 and to receive and access funds sent to them over the RTP network immediately.

RTP Facts and Frequently Asked Questions:

- *Ubiquity*—All federally insured U.S. depository institutions can participate on the RTP network.
- *Access to the RTP network*—Federally insured U.S. depository institutions have the option to directly connect to the RTP network or use an electronic connection provided by a third-party service provider such as a core processor, a hosted gateway, a bankers' bank or a corporate credit union.
- *Pricing*—The RTP network has a single price for all participants regardless of size, with no volume discounts, no volume commitments and no monthly minimums. Pricing for the RTP network is available on The Clearing House's website (*www.theclearinghouse.org/*).
- *24/7*—The RTP network operates 24/7, which allows financial institutions to send or receive payments at any time.
- *All Types of Payments*—The RTP network supports all types of payments (B2B, B2C, C2B, P2P, G2C). The RTP system may not be used to make a payment for a foreign account.
- *Flexible Messaging Functionality*—Rich, flexible messaging functionality (non-payment messages) is included to support communications between participants and value-added products. For example, the RTP system provides messaging capability enabling a request for payment of a bill or invoice directly via the RTP network.
- *Immediate Availability*—Recipients receive the payment within seconds of the sending financial institution initiating the transaction; the receiving financial institution is required to make funds available immediately, except where necessary for risk management or legal compliance purposes.
- *Payment Certainty*—Sending financial institutions are not permitted to revoke or recall a payment once it has been submitted to the RTP network. However, there is a process to facilitate communication between financial institutions around return of funds sent in error or if there is suspected fraud.
- *Transaction limits*—The RTP network is strictly a credit push system. The credit transfer limit is currently $25,000.
- *Prefunding*—RTP participants that intend to send payments over the RTP network are currently required to contribute funding to a special deposit account at the Federal Reserve Bank of New York (an account that may be used by all RTP participants regardless of the Federal Reserve district in which they are located). A participant may use a liquidity provider such as a bankers' bank or corporate credit union to provide its funding. An RTP participant that only receives payments over the RTP network does not have to contribute funding.
- *Rules Governing the RTP Network*—The RTP Participation and Operating Rules apply to all network messages and are available on The Clearing House's website (*www.theclearinghouse.org*).

PREPARED STATEMENT OF ROBERT A. STEEN

CHAIRMAN AND CEO, BRIDGE COMMUNITY BANK, ON BEHALF OF THE INDEPENDENT COMMUNITY BANKERS OF AMERICA

SEPTEMBER 25, 2019

Chairman Crapo, Ranking Member Brown, and Members of the Committee, I am Bob Steen, Chairman and CEO of Bridge Community Bank in Mount Vernon, Iowa.

I testify today on behalf of the Independent Community Bankers of America and community banks nationwide, with more than 52,000 locations. I have played an active role in ICBA over the years including serving on the Bank Operations and Payments Committee. Thank you for the opportunity to testify at today's hearing titled "Facilitating Faster Payments in the U.S." I believe that it is imperative that the U.S. develop a robust real-time payments system to meet consumer demand and stay competitive with the rest of the world. This system must create access for all institutions, regardless of size or charter type, and must be situated in a competitive environment with end-user choice.

How we achieve this goal is critical. A real-time payments system is too important to be entrusted to a private monopoly. The two dozen largest banks simply cannot own and operate the U.S. payments system. ICBA strongly supports the Federal Reserve's decision to build FedNow, a real-time payments system that will give direct access to all financial institutions and their customers. I am pleased to provide the perspective of thousands of community banks such as ours that strive to remain independent and competitive by offering state-of-the-art payment products to our customers.

What Faster Payments Mean to My Bank and Community Banks

Bridge Community Bank is a $96 million asset community bank founded in 1903 and owned by our 20 employees. We have three full-service locations serving rural communities in growth markets in and around Cedar Rapids and Iowa City. Bridge Community Bank meets the needs of our communities through small business, agricultural, and consumer banking. The rural communities we serve are beyond the appetite of most of the largest national banks because we do not have the population density to suit their transaction-based business model. What works for Bridge Community Bank is a personal relationship model in which we serve the totality of a family's business and personal banking needs, both deposits and lending—often two to three generations, and sometimes four and even five. The transaction account is the key to the broader customer relationship and at the heart of community banking. We have long recognized that payments innovation is critical to the long-term prosperity and independence of Bridge Community Bank and the community banking industry.

In recent years, we have seen numerous nonbanks move into the payments arena. The players include Square, PayPal, also doing business as Venmo, and many others. We are losing our place as an industry, and we must be part of the solution. Many of these nonbank providers are willing and able to absorb long-term and extraordinary losses for the single purpose of growing market share. Their losses do not translate to our gains. My industry cannot and should not do what they do. Still, if we lose the payments side of the customer relationship, our franchise will have no value. This is why I have invested so much of my time and energy over the years into payments innovation. We have incubated multiple payments projects in our bank. Of note, the ExcheQ mobile application, on which we partnered with a community bank in the development and testing, allows any account holder to pay any other person as easily as sending a text or email. Using the ubiquitous ACH same day settlement system, ExcheQ is able to send money to anyone in the U.S. that has an account at any financial institution without a payment application on the receiver's mobile device. This type of innovation is critical to keeping our bank and other community banks relevant to both our customers and our community, especially but not exclusively for the younger generation. FedNow, a neutral, real-time settlement network, will be critical to our ability to continue to innovate on behalf of our customers. Once FedNow is fully operational and ubiquitous, our customers will be able to send money in real-time using ExcheQ without being dependent on our core banking system. That, by itself, is magic.

U.S. Rapidly Being Marginalized in the Payments Services That Underlie Our Economy

It is an unfortunate reality that the U.S. lags much of the rest of the world in faster payments. Globally, 40 real-time payments systems are live. Europe, Mexico, and Australia have already implemented real-time systems. For example, one of our own bank payment solutions can achieve a real-time transaction for our customers utilizing a Mexican prefunded account connecting through the Central Bank of Mexico SPEI network. These systems are realizing significant growth. In China, for example, there are now more than 25 million faster payments made every day, more than double the daily average from just a year ago.

America's economic vitality depends on a modern, continually innovating, and globally competitive payments system. As more and more transactions move online, delays in settlement will extend cross-party risk and ultimately hobble the evolution of American commerce. Transactions have become instantaneous, but the underlying payments that support them continue to lag. A dynamic economy needs to be supported by a modern payments system. I believe that FedNow will promote U.S. competitiveness in payments and is a natural extension of the Federal Reserve's historical role in ensuring access and secure payments for all financial institutions.

Customers Need a Payment System That Matches Their Expectations

Customers expect an electronic payment, especially a payment initiated on a mobile device, to arrive as soon as it is sent. However, most payments today take one-to-three days to clear and settle, delaying customer access to funds. A customer might need a paycheck or other incoming payment to clear before making a mortgage or car payment and avoid late penalties. These delays come at a real cost. A single delay can result in unnecessary returns, late charges, credit history impact, and even affect the consumer spending that sustains our economy. Funds availability delays make it more difficult for a small business to manage money between and among accounts to meet payroll, service debts, pay a supplier, or other immediate and critical expenses.

Real-time payments will facilitate commerce by ensuring immediate access to funds, without holds or delays. As our economy evolves, immediate access to funds will become increasingly important. The emergence of task-based employers such as Uber and Lyft and other "sharing economy" peer-to-peer arrangements must be supported by a real-time payments system that allows for the true instantaneous exchange of funds. Payments innovation must keep pace with broader technological innovation.

As Federal Reserve Governor Brainard has noted, the unmet demand for real-time payments is fueling the development of solutions that bypass banks and even sovereign currencies. Dislodging banks and sovereign currencies from their historic role in the exchange of payments will likely have a profound, unintentional impact on the global economy.

The Clearing House Solution Fails Critical Tests

In November 2017, the largest banks, through The Clearing House, launched a real-time payments network. The Clearing House effort has failed on the critical parameters of creating access for all financial institutions and ubiquity. A system that lacks these is of little true value to American consumers and businesses. It is my understanding that only 15 financial institutions—out of nearly 11,000 nationwide—are actively engaged on the network. The Clearing House system will not have the reach, on its own, to be the effective real-time payments solution our economy needs. In fact, a private sector payments provider has never achieved nationwide reach on its own in checks, ACH, cards, or wire transfers. Unlike the Federal Reserve, The Clearing House has neither the mission nor the capability to achieve this critical goal. It cannot be the only option.

Most critically, The Clearing House system is a private system owned by the largest banks. As a matter of principle, ICBA is against any monopoly or other concentration of economic power. This is one of our core and foundational values. Monopolies harm consumers and ultimately escalate costs, erode service quality, and limit choice. What's more, monopolies create financial and systemic risk. Real-time payments are too important to our economic prosperity to leave in the hands of two dozen of the largest banks, especially an organization that does not have a proven track record of reaching smaller financial institutions in clearing checks, ACH, and wire transfers.

Two years ago, The Clearing House obtained approval from the U.S. Justice Department to build a private real-time payments network based on a pledge that they would offer the same entry and transactional pricing to all financial institutions. The Clearing House asked for Justice's assurance that the agency would not bring an antitrust lawsuit against their payments network. Recently, the Clearing House added a caveat to its pledge not to offer volume discounts—that it must not have a competitor. That sounds a lot like: "Trust us. We won't behave like a monopoly as long as we can be a monopoly." While the caveat has since disappeared from their website, this posture should only strengthen our collective demand to ensure access and create competition and choice.

In addition to questions of monopoly power and its abuse, there's the question of systemic risk. If the U.S. is limited to a single real-time payments system, we will be vulnerable to a critical disruption of the system which would have serious and lasting economic repercussions. It makes no sense for us to acquiesce to that level of risk. Having more than one settlement provider creates a critical safety net for the U.S. payment system. The Federal Reserve has a long and proven record of managing resilient systems in times of crisis.

The Federal Reserve Must Be Involved in Faster Payments

Bridge Community Bank and ICBA strongly support the recent announcement by the Federal Reserve to build and operate a real-time payments settlement system. In this role the Federal Reserve can guarantee competition, provide choice for consumers, businesses, and banks, create true universal access and payment ubiquity, and keep pace with the rest of the world. This system should ultimately interoperate with other systems such as The Clearing House system, much as it has with ACH and paper checks.

Competition

The remedy for monopoly is competition. Competition is the defining feature of our economic system and the foundation of our national prosperity. It creates choice for consumers as well as businesses and promotes innovation in the development of new products to meet consumer preferences and needs. Competition promotes efficiency and helps contain costs.

What is broadly true in our economic system is also true in payments. The Federal Reserve's development and operation of a real-time gross settlement system would guarantee needed competition. This point bears repeating: FedNow will not displace The Clearing House system. It will create an alternative to operate alongside any private sector system, ensuring equitable access to banks and communities of all sizes nationwide. This is the Federal Reserve's historic role in check clearing, ACH, and wire services. It's is their duty to play the same role in faster payments.

FedNow is true to the historic legacy of the Federal Reserve. One of the initial responsibilities of the Federal Reserve was to serve as a clearinghouse of checks, ensuring that a customer's good check is honored, regardless of whether their bank is a Wall Street bank or located on Main Street in Mount Vernon, Iowa. The Federal Reserve, leveraging its regional bank structure, demanded reasonable availability of funds thereby limiting intentional float and delays at the expense of the public. During the past century, every eligible financial institution, regardless of size, has had equal access to the Nation's payments and settlement systems at par through their local district Federal Reserve Bank if they have so desired.

Reach

Most importantly, the U.S. does not need another closed-loop real-time payment system in which some financial institutions participate, and others are excluded. All financial institutions, regardless of size or charter type, and all customers, whether they live in small or rural communities that are exclusively served by community banks, or in suburban or urban communities, must have access to a real-time payments network. To create an inclusive financial system, every single financial institution should have the opportunity to participate. I firmly believe that simply cannot happen without the Federal Reserve's role in real-time settlement.

The Fed is uniquely positioned to provide access to all 11,000 financial institutions because all of these institutions have access to a settlement account and a service connection with the Fed. The Federal Reserve operates a check, ACH, and wire transfer service. The Clearing House simply cannot match this capability. In short, industrywide ubiquity may never be achieved without the Fed developing and operating a real-time gross settlement system and interoperating with the private sector. If we want to maximize access to real-time payments for financial institutions and consumers nationwide, the Federal Reserve, as the U.S. central bank, must be involved.

Affordability

If history is any guide, the Fed will maintain affordable as well as universal access to faster payments. The Federal Reserve offers a fair and affordable pricing structure, even to the smallest of the small financial institutions like our bank. For example, as the first bank to forward an electronic check file to the Federal Reserve shortly after the effective date of the Check21 Act, our bank saw an immediate 60 percent savings for check services. Universal access, as critical as it is, has little value if not offered on affordable terms. That is exactly what the Fed has done over my long career.

Direct Access for Community Banks

The Fed is trusted among community banks. Each community bank has a relationship manager and the opportunity for direct access to the Fed. I know our representative's name and I know his cell number. He answers the phone. As a community bank, I know that I have direct and easy access to Federal Reserve support services even after our banking hours. I place a high value on this access. I would not have this access with the largest banks or their proxy which historically have served as a settlement provider for only a few of the Nation's 11,000 financial institutions.

A Platform for Innovation

Ubiquitous access for all payments system end users to faster, more efficient and more secure payments—irrespective of their financial institution's size or charter type—will also provide a foundation for a payments system that will lead to more innovation. Once ubiquity is achieved, new use cases will emerge that we have not thought of. Real-time payroll, immediate bill payment, person-to-person payments, and business-to-business payments that are actually real-time will become the norm.

A Natural Extension of the Federal Reserve's Current Role

The Federal Reserve's entry into real-time payments is part of a natural evolution from its involvement in check clearing, ACH payments, and wire transfers. By playing a settlement role in these services, the Fed has strengthened the payments system by providing safety, integrity, choice and equitable access to all financial institutions. The Federal Reserve will bring the same critical benefits to real-time payments.

A Deterrent to Further Consolidation

As I stated at the outset, payments innovation, offering customers what they want when they want it, is critical to the prosperity, sustainability, and continued independence of community banks. A monopoly in the payments space and especially in real-time payments, operated by the largest banks, would surely marginalize our bank and our industry, weaken our customer relationships, and ultimately speed the pace of consolidation that is changing the American financial services landscape. The Federal Reserve's involvement, together with tiered regulation based on size and complexity, which—thanks to Chairman Crapo and this Committee—has been enacted and is now directly benefiting community banks, will help to preserve and strengthen the community banking industry, which is so vital to the U.S. economy.

Conclusion

Thank you again for convening this hearing and raising the profile of a critical issue for the future of American commerce and consumer finance.

The demand for faster payments is already here, and it's only going to increase. By playing a settlement role in real-time payments as it already does for checks, ACH payments and wire transfers, the Fed will provide safety, integrity, choice and equitable access to all financial institutions. The Fed has not only the authority, but the duty, to build and operate our real-time settlement system.

PREPARED STATEMENT OF GEORGE SELGIN

SENIOR FELLOW AND DIRECTOR, CENTER FOR MONETARY AND FINANCIAL ALTERNATIVES, CATO INSTITUTE

SEPTEMBER 25, 2019

Introduction

Chairman Crapo, Ranking Member Brown, and distinguished Members of the Committee on Banking, Housing, and Urban Affairs, my name is George Selgin, and I am the Director of the Cato Institute's Center for Monetary and Financial Alternatives. I am also an adjunct professor of economics at George Mason University, and Professor Emeritus of Economics at the University of Georgia.

I'm grateful to you for allowing me to take part in this hearing on "Facilitating Faster Payments in the U.S." The slow speed of many payments in this country is a cause of serious inconvenience and substantial losses to American businesses and consumers, and one that places an especially great burden on people living paycheck-to-paycheck, who can least afford to wait, sometimes for days, for checks or employer direct deposits to clear.[1] For that reason it is essential that Congress do everything in its power to facilitate the speeding up of payments in this country.

To assist Congress in that endeavor, I wish to draw your Committee's attention to some dangers posed by the Federal Reserve decision to proceed with FedNow—a real-time retail payments service that will compete directly with private-sector retail payments services. Specifically, I wish to discuss four ways in which the Fed's plan might hinder rather than facilitate the achievement of an equitable, efficient, and safe U.S. fast payments system, and to suggest steps Congress should take to guard against this outcome.

The Federal Reserve as a Payment Service Competitor

As a rule, competition is an effective—if not the most effective—means for encouraging providers of services to price those services equitably, to produce them efficiently, and to improve their quality over time. However, these outcomes depend on the presence of a level playing field on which all providers compete—that is, they depend on the various providers having roughly equal legal privileges and obligations. In the absence of a level playing field, the presence of multiple providers alone does not guarantee good outcomes. Instead, special care must be taken to guard against bad ones.

The Federal Reserve banks enjoy many legal advantages over private suppliers of payment services. They command a monopoly of bank reserves that serve as means of final payment; they are empowered to regulate commercial banks and some other private-sector payment service providers; and they are exempt from antitrust laws. Finally, although the 1980 Monetary Control Act requires that the Fed charge prices for its services that recover those services' capital and operating expenses, it only needs to do so over a "long run" of unspecified length, and then only according to accounting methods of its own choosing that are not subject to external review.

These and other Fed privileges mean that, when it enters into direct competition with private-sector payment service providers, it does so on a playing field that it can easily slant in its favor. It is owing to this that the Fed itself has established strict criteria it must meet before offering any new payment service, including the requirement that the service in question "be one that other providers alone cannot be expected to provide with reasonable effectiveness, scope, and equity."[2]

In responding to the Fed's request for comment regarding "Potential Federal Reserve Actions To Support Interbank Settlement of Faster Payments", I argued against the Fed's then-proposed retail RTGS (Real Time Gross Settlement) payment service partly on the grounds that it did not meet the Fed's own criteria for providing new payments services.[3] I also argued that the new service would delay progress toward a ubiquitous U.S. fast payments system. I continue to hold these views.

I also fear that, instead of preventing private-sector payment service providers from engaging in anticompetitive behavior, the Fed will itself engage in such behavior. In my testimony today, I wish to draw attention to four particular anticompetitive dangers that the Fed's entry into the fast payments business poses, and to recommend steps Congress should take to guard against each.

Postponed Fed Settlement System Reform

The first danger is that the Fed will treat FedNow as a substitute for a 24x7x365 expansion of the operating hours of Fedwire, its wholesale RTGS service, and NSS (the National Settlement Service), a separate multilateral settlement service that is also owned and operated by the Federal Reserve banks.[4] The availability of

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[1] For some figures see Aaron Klein, "How the Fed Can Help Families Living Paycheck to Paycheck", Brookings Series on Financial Markets and Regulations, November 22, 2017, and idem., "The Fastest Way To Address Income Inequality? Implement a Real-Time Payment System", Brookings Series on Financial Markets and Regulations, January 2, 2019. Available at *https://www.brookings.edu/research/how-the-fed-can-help-families-living-paycheck-to-paycheck/* and *https://www.brookings.edu/research/the-fastest-way-to-address-income-inequality-implement-a-real-time-payment-system/*, respectively.

[2] See Board of Governors of the Federal Reserve System, "Policies: The Federal Reserve in the Payments System", available at *https://www.federalreserve.gov/paymentsystems/pfs_frpaysys.htm.*

[3] Available at *https://www.cato.org/publications/public-comments/re-potential-federal-reserve-actions-support-interbank-settlement.*

[4] The NSS serves "depository institutions with Federal Reserve master accounts that settle for participants in clearinghouses, financial exchanges and other clearing and settlement arrangements." For further details see FRBServices.org, "National Settlement Service", available at *https://www.frbservices.org/financial-services/national-settlement-service/index.html.*

24x7x365 Fed settlements is essential to achieving faster (though not necessarily real-time) payments on other payment services. But instead of hastening to offer that service, the Fed may delay doing so to limit private payment services' ability to compete with it.

The danger here stems from the Fed's monopoly of final means of payment, including bank reserves. Because of that monopoly, most private noncash payments, including most check, card, and ACH (Automated Clearing House) payments, can only be completed with the help of either Fedwire or the NSS or both. Only once settlement takes place can recipient banks credit funds to a payee's account without assuming some credit risk. Because Fedwire and the NSS operate only on weekdays, excluding holidays, and then with limited hours, retail payment services that rely on them are correspondingly limited in their ability to process payments quickly at all times.

Although it would also enhance the efficiency of private real-time payments services, the main benefit of 24x7x365 Fed settlement services would consist of a substantial reduction in delays on "legacy" payment networks. [5] For example, today's Fedwire and NSS operating hours currently stand in the way of National Automated Clearing House Association's (NACHA) long-standing effort to enhance ACH's same day payment services by providing for a third ACH "processing window." Although NACHA had hoped to make this third window available by September 2020, and the change required only a minor extension of Fedwire and NSS operating hours, the Fed failed to prepare for the change on time, forcing NACHA to postpone its planned reform until March 2021. [6]

When the Fed requested public comment on whether it should establish its own fast payments network, it also asked whether it should either arrange to have Fedwire and the NSS operate 24x7x365 or establish a new "Liquidity Management Tool" for the purpose of allowing 24x7x365 transfers among commercial banks' Federal Reserve accounts. Almost every response to this question favored having the Fed pursue one of these proposed reforms (most respondents did not care which), making the proposal much less controversial than the Fed's plan to establish its own retail RTGS service. Yet despite this, and the relative easiness and great potential benefits of the asked-for reform, the Fed ultimately chose to do no more than continue to "explore" the possibility of offering 24x7x365 settlement services, and to perhaps seek comment upon the proposal yet again! [7]

Why is the Fed dragging its feet on an almost universally favored reform that could alone suffice to eliminate most of the more notorious payment delays in this country? [8] The Fed's actions seem at odds with its overarching public mission. But they are what one would expect from a firm endeavoring to compete successfully with rival payment service providers. For example, when NACHA was first endeavoring to make same-day ACH payments possible, its efforts were opposed by several large banks. It was widely suspected, according to a contemporary report, that this opposition stemmed from those banks' intent "to build their own proprietary electronic payment systems, which could give them a leg up on smaller banks." [9] The Fed's hesitation to make 24x7x365 Fed settlements available to private payment

[5] Because RTP settlements occur on the books of a special Fed account jointly owned by RTP participants, it can operate 24x7x365. However, its participants depend on Fedwire or the NSS to occasionally replenish their individual RTP account balances. The settlement services' limited operating hours raise participants' costs of using RTP by obliging them to maintain larger non–interest earning RTP account balances than they otherwise might, especially going into weekends. Concerning the non–interest-bearing status of RTP account balances, see below.

[6] Jim Daly, "Fed Delay Causes NACHA To Postpone a Third Processing Window for ACH Transactions for Six Months". *Digital Transactions*, September 30, 2019. Available at *https://www.digitaltransactions.net/fed-delay-causes-nacha-to-postpone-a-third-processing-window-for-ach-transactions-for-six-months/*.

[7] 84 FR 39301. Available at *https://www.govinfo.gov/content/pkg/FR-2019-08-09/pdf/2019-17027.pdf*.

[8] Because the most costly payment delays at present are those that keep workers waiting not hours but days for payments to clear, "The Fastest Way To Address Income Inequality" stemming from such delays is, with all due respect to Aaron Klein (op. cit.), not to have the Fed implement FedNow, which will not be ready for several years, but to have it offer 24x7x365 settlement services, which should take much less time.

[9] Kevin Wack, "How Big Banks Killed a Plan To Speed Up Money Transfers". *American Banker*, November 13, 2013. Available at *https://www.americanbanker.com/news/how-big-banks-killed-a-plan-to-speed-up-money-transfers*. Although Wack here refers to TCH as NACHA's "most visible foe," it only appears that some of TCH's owner banks opposed NACHA's plan. In a comment letter TCH itself submitted, in its capacity as an ACH operator, to NACHA in February 2015, it expressed its overall approval of NACHA's proposal. TCH's comment letter is available at *https://www.theclearinghouse.org/-/media/files/association-documents-2/20150206-comment-letter-to-nacha-supporting-same-day-settlement.pdf*.

service providers may likewise reflect its own desire to give FedNow "a leg up" on other payment networks.[10]

Whatever the Fed's motives, Congress should not allow it to delay a badly needed enhancement of its settlement services any longer. Instead, it should give the Fed 2 years within which to either place its Fedwire and NSS services on a 24x7x365 operating basis, or establish an alternative 24x7x365 Liquidity Management Tool. If Congress does not do this, I fear that Congress will overlook the most important of all steps it might take to dramatically and rapidly enhance the speed of U.S. retail payments.

Volume-Based Pricing Favoring Large Banks

A second danger the Fed's entry into the fast payments business poses is that, by resorting to volume-based pricing, the Fed will ultimately put small banks that wish to offer fast payment services to their customers at a disadvantage.

Because many are counting on the Fed to guard against rather than introduce volume-based fast payment fees, some background is required to understand why that expectation exists, and why just the opposite might happen.

The only potentially ubiquitous real-time payments service that exists at present, the RTP system established by TCH (The Clearing House) in 2017, presently operates on a contractually binding flat-rate basis, with no minimum volume requirements.[11] But TCH's flat-fee commitment isn't absolute: instead, it allows RTP to alter its pricing policy in the event that the Fed enters into competition with it. Noting this, Fed officials and others have argued that RTP cannot be trusted to make certain that small banks continue to receive equitable treatment, instead of finding themselves placed at a disadvantage relative to their large competitors. That TCH is itself owned by 25 of the Nation's largest banks makes the risk to smaller banks seem all the more obvious. Consequently, the Fed and others argue, having FedNow directly compete with RTP is the surest way to keep RTP from reneging on its flat-fee commitment.

But closer consideration of TCH's general pricing practices, along with some history, suggest that the Fed's entry is more likely to have just the opposite consequence. Regarding TCH's practices, in seeking a statement from the Justice Department's Antitrust Division "of its present intention not to seek any enforcement action against" the RTP system it was then developing, TCH explained that it:

> operates on a "utility" model, charging fees only to cover the costs incurred in operating its CHIPS, EPN, and check imaging systems and to support future innovation, and does not pay dividends to its owner banks.[12] Accordingly . . . TCH owner banks . . . will benefit by participating in the RTP system and enhancing their abilities to compete more effectively among themselves and with non-TCH owner banks and nonbank payment service providers.[13]

The veracity of TCH's claims is attested to both by the known pricing practices of its established payment systems and by the Justice Department's conclusion that RTP did not in fact pose "significant anticompetitive threats."[14]

FedNow, in contrast, does pose such a threat, as is clear from what happened in the case of ACH payments. The Fed competes with TCH, and in the past competed with other private-sector providers, in providing ACH payment services. TCH initially charged flat ACH fees. But during the 1990s, the Fed, in an effort to compete more aggressively in an increasingly national ACH market, resorted to volume-

[10] NACHA itself seems to have anticipated this outcome. In its own comment letter concerning the Fed's various proposals, it complained that the Fed already appeared to be retreating from what once seemed to be a commitment to further expand Fedwire and NSS operating hours, while expressing its fear that it was doing so in order to favor the establishment of its own real-time retail payments systems, over measures that could further expedite payments on legacy systems. See Jim Daly, "NACHA Wants the Fed To Take a Broader View of Faster Payments", *Digital Transactions*, December 5, 2018. Available at *https://www.digitaltransactions.net/nacha-wants-the-fed-to-take-a-broader-view-of-faster-payments/*.

[11] For RTP's pricing policies see *https://www.theclearinghouse.org/payment-systems/rtp/-/media/00a1f095c9a049fea6c3e2e5fbc2c6ad.ashx.*

[12] CHIPS (for Clearing House Interbank Payment System) is TCH's large-value interbank payment service, while EPN (for Electronic Payments Network) is its ACH (Automated Clearing House) operations service. [This writer's note.]

[13] Richart Taffet, "The Clearing House Payment Company LLC's Request for Business Review Letter", October 11, 2016. Available at *https://www.justice.gov/atr/page/file/998216/download.*

[14] Andrew C. Finch, "The Clearing House Payments Company LLC Business Review Request", September 21, 2017. Available at *https://www.justice.gov/atr/page/file/998201/download.*

based ACH fees.[15] The Fed's move compelled TCH to follow suit to avoid losing the business of its larger ACH customers. Yet TCH's ACH prices are still more favorable to small banks than those charged by the Fed, which charges many smaller banks five times the per-transaction fee it charges its largest customers.[16]

It was to protect itself from such potential Fed competition, and not (as Fed officials have suggested) to be able to ultimately resort to discriminatory pricing, that TCH made its flat-rate commitment contingent on the Fed's not entering into competition with it. Were TCH not to do this, it would risk having FedNow bid away its large participants.

To avoid having volume-based pricing undermine the goal of equitable real-time payments, Congress must do more than merely trust the Fed not to engage in such pricing. At very least, it should insist that the Federal Reserve Board follow TCH's example by making a public commitment to refrain from offering volume-based discounts on FedNow or, at very least, by publicizing a specific, anticipated FedNow pricing policy, such as it presumably employed in assessing the new service's feasibility and desirability. As then Richmond Fed economist John Weinberg observed some years ago, "When the Fed is one of several competitors, it can contribute to the efficiency of the market by adopting a clear pricing policy to which other sellers can react."[17]

Prejudicial Treatment of Balances in Jointly Held Fed Accounts

The third danger stems from the Fed's ability to refuse to classify bank balances held in jointly owned Fed accounts as reserves, and to do so even when the accounts in question are "intended to facilitate settlement between and among depository institutions participating in private-sector payment systems."[18]

Fed balances classified as "reserves" earn interest, while those not so classified do not. Consequently, by refusing to classify the jointly held Fed balances held by banks participating in a private payments network as reserves, the Fed adds to the cost of participating in that network, and hence to the relative attractiveness of other networks, including those it itself operates, that aren't subject to the same "reserve tax." The Fed's status as bank regulator can thus allow it to compete unfairly by "raising [its] rivals' costs."[19]

Although the Fed allows "only an institution eligible to have a Federal Reserve account under the applicable Federal statute and Federal Reserve rules, policies, and procedures" to be a joint account holder, it reserves the right to determine whether balances in joint accounts count as reserves on a balance-by-balance basis.[20] Today, the Fed administers three joint accounts serving to facilitate settlements among participants in TCH's CHIPs, RTP, and EPN networks.[21] So far as

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[15] Some years earlier, when the Fed first sought comment on its plans to establish nationwide EFT (Electric Funds Transfer) services, the Justice Department's Antitrust Division commented in favor of the Fed's adoption of a nondiscriminatory pricing system, noting that a discriminatory pricing system could prove to be "as substantial a bar to competition as exclusionary rules." Anatoli Kuprianov, "The Monetary Control Act and the Role of the Federal Reserve in the Interbank Clearing Market", *Federal Reserve Bank of Richmond Economic Review*, July/August 1985, p. 31. Available at *https://www.richmondfed.org/-/media/richmondfedorg/publications/research/economic_review/1985/pdf/er710403.pdf.*

As Mark Weinberg has observed, whereas uniform average-cost pricing generally "maximizes net social benefits subject to the constraint that total revenues from the sale of the product just equal total costs," volume-based pricing, a form of price discrimination, does not. Consequently the Fed's resort to the latter "raises some important questions," including whether "the Reserve Banks' 'business interests' [are] in conflict with their public policy responsibilities." "An efficiency perspective," he continues, "dictates that a loss of market share by the Federal Reserve is neither good nor bad per se. What matters is the overall cost efficiency of the market. If the Federal Reserve is replaced by providers with lower costs, then such a change should be accommodated. The goal of pricing policy, however, should be that only efficiency-enhancing losses are experienced." John A. Weinberg, "Selling Federal Reserve Payment Services: One Price Fits All?" *Federal Reserve Bank of Richmond Economic Quarterly*, Fall 1994, pp. 3 and 8. Available at *https://www.richmondfed.org/-/media/richmondfedorg/publications/research/economic_quarterly/1994/fall/pdf/weinberg.pdf.*

[16] Thomas Wade, "How the Federal Reserve's Automated Clearing House Informs the Fed's Proposed Real-Time Payments Entry", *American Action Forum*, July 11, 2019. Available at *https://www.americanactionforum.org/insight/the-federal-reserves-automated-clearing-house/*.

[17] Weinberg, op. cit., p. 20.

[18] For the Fed's rules for establishing such joint accounts see 82 FR 41951, available at *https://www.govinfo.gov/content/pkg/FR-2017-09-05/pdf/2017-18705.pdf.*

[19] The seminal paper here is Steven C. Salop and David T. Scheffman, "Raising Rival's Costs", *American Economic Review*, May 1983, pp. 267–271. Available at *https://www.jstor.org/stable/1816853?seq=1#metadata_info_tab_contents.*

[20] 82 FR 41956.

[21] Although most EPN ACH payments are settled using Fedwire, TCH relies on a joint Fed account to assist in the settlement of items sent by Fed ACH participants to EPN participants

I'm aware, it has not yet chosen to treat balances in any of these accounts as reserves. Consequently those balances neither bear interest nor qualify as "High Quality Liquid Assets" that can satisfy Basel's LCR (Liquidity Coverage Ratio) requirements.

I can think of no economic reason why the Fed should not classify all Federal Reserve bank balances held in joint accounts used in settling payments as reserves, and to accord such balances the same privileges as other reserve balances. RTP account balances, for example, are no less liquid than banks' regular Fed account balances, and serve the same purpose of supplying their owners with means for settling payments. That banks choose to fund their RTP accounts rather than their individual Fed accounts, so as to allow them to make real-time payments instead of relying on slower ones, should not subject them to any avoidable penalties.

Moreover, by refusing to treat RTP balances as reserves the Fed may complicate its monetary policy operations unnecessarily by creating a new "autonomous" determinant of the total stock of bank reserves. As the Fed itself explains:

> if joint account balances are not treated as reserves, they are a factor affecting the supply of reserve balances, meaning, all else equal, movements in joint account balances have similarly sized but opposite effects on the supply of reserve balances, which the Federal Reserve will need to offset to provide the appropriate level of reserves in a scarce reserve regime.[22]

In short, the Fed's ability to refuse to classify balances held in joint accounts "intended to facilitate settlement" on private payments system with which it competes represents a clear conflict of interests. To resolve this conflict, and thereby assure that the Fed competes fairly with rival payment service providers, Congress should compel the Fed to classify all balances held in joint Federal Reserve bank accounts as reserves, provided only that the accounts in question are designed to facilitate settlements on private payments networks. Congress should also have the Government Accountability Office (GAO) occasionally review the Fed's handling of applications for such joint accounts, to ensure that it continues to abide by its current guidelines for granting them.

Abuse of Monetary Control Act Loopholes

Finally, I wish to point to the risk that the Fed will take advantage of loopholes in the 1980 Monetary Control Act (MCA) to charge prices for its FedNow services that fail to cover their full costs, as that act requires. Thanks to its monopoly of paper currency, the Fed earns substantial "seigniorage" revenue it can use to cross-subsidize its other payment services to the extent that MCA loopholes allow it.

Although the MCA is supposed to rule out such cross-subsidies, there are at least two defects in its provisions that can prevent it from doing so. One concerns the Act's requirement that the Fed's service fees cover its costs "over the long run." Because it fails to define "the long run," the Act as written allows the Fed to interpret the phrase as it pleases. In contrast, private-sector payment service providers must generally be able to recover the cost of new services rapidly enough to achieve a positive present value for those services.

Fed officials claim that they generally endeavor to recover the Fed's expenditures for established services within a 10-year period, but that they expect FedNow's "first instance of long-run cost recovery to occur outside" that 10-year cost recovery period.[23] However, they do not say how far outside, and the Fed incurs no penalties for failing to recover its costs within any specific length of time.[24] It follows that the Fed's investment in FedNow needn't have a positive present value, so that it can set FedNow fees below what a private-sector provider of an equally costly service could afford.

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that choose to be identified by UPIC (Universal Payment Indication Code) numbers only, so as to avoid divulging confidential banking information.

[22] See Federal Reserve System, "Final Guidelines for Evaluating Joint Account Requests", at *https://www.govinfo.gov/content/pkg/FR-2017-09-05/pdf/2017-18705.pdf.* Although the Fed presently operates an abundant reserve regime, recent experience has illustrated, rather dramatically, that under certain conditions the Fed may still have to intervene to offset autonomous reserve losses. See Nick Timiraos and Daniel Kruger, "Fed Intervenes To Curb Soaring Short-Term Borrowing Costs", *Wall Street Journal*, September 17, 2019. Available at *https://www.wsj.com/articles/fed-to-conduct-first-overnight-repo-transactions-in-several-years-11568729757.*

[23] 84 FR 39314.

[24] GAO, "Federal Reserve's Competition With Other Providers Benefits Customers, but Additional Reviews Could Increase Assurance of Cost Accuracy", GAO-16-614, August 2016. Available at *https://www.gao.gov/assets/680/679388.pdf.*

A second MCA loophole leaves to the Fed itself the choice of an internal cost accounting system by which the Fed allocates its expenditures among its various activities, while failing to provide for periodic and systematic external reviews of that accounting system to assure its adequacy. In consequence the last external review of the Fed's cost accounting system took place in 1984! External assessments of the Fed's success in complying with the MCA's cost recovery provisions, such as that undertaken by the GAO in 2016,[25] are therefore only as accurate as the Fed's own internal audits—a highly unsatisfactory circumstance.

By closing these MCA loopholes, Congress can prevent the Fed from underpricing its payments services, including FedNow. To do so, it should insist that the Fed offer compelling proof that it will be able to recover the costs of FedNow rapidly enough to give that project a positive present value using an equitable and competitive fee structure. Congress should also follow the GAO's 2016 recommendation that it provide for periodic independent reviews of the Fed's cost-accounting practices.[26] Together these changes should go far in assuring that the Fed competes fairly with private payment service providers.

Conclusion

I conclude my testimony by observing that none of the steps I have recommended to Congress would prevent the Fed from doing all that it can possibly do to facilitate faster payments in the United States. My recommendations will only serve to make sure that in competing with private-sector payment service providers, the Fed plays by the rules, as it must if it is to contribute to rather than hinder the speeding-up of U.S. payments. A well-intentioned Fed should therefore have no objection to them, while an ill-intentioned one will make them indispensable.

PREPARED STATEMENT OF SHEILA C. BAIR

FORMER CHAIR, FEDERAL DEPOSIT INSURANCE CORPORATION

SEPTEMBER 25, 2019

Chairman Crapo, Ranking Member Brown, Members of the Committee. Thank you for the opportunity to testify today to present my personal views on the need to facilitate faster payments in the United States. I applaud the Federal Reserve Board's recently announced plans to build "FedNow"—an interbank settlement system to support real-time payments. This initiative by the Fed will provide the foundation upon which to build the next generation of instantaneous payment services, in partnership with the private sector. At the same time, the Fed's operational involvement will ensure that the payments system of the future is resilient, safe, and broadly accessible on fair and equitable terms.

Payments are the lifeblood of an economy. Any major disruption in the ability of households and businesses to transfer funds in payment of goods and services would have catastrophic results. As such, our payments system is an essential public utility and like other public utilities, cannot be left solely in the hands of private enterprise. This is why the Federal Reserve has long played a core role in payment services, typically operating alongside and in support of private sector systems.

The current payments system is fraught with frictions and inefficiencies. When we send money, the withdrawals from our bank accounts are usually immediate. However, it can take days for the money to go from our banks to recipients' banks where the funds can be accessed. The wait creates costs and hardships, particularly for households and small businesses on tight budgets—for the house keeper waiting for her clients' check to clear before she can pay her rent, or the small business waiting for a customer's check to clear before it can pay its workers. These delays in payments can lead to a cascade of negative consequences, including forcing households and businesses to rely on expensive forms of credit to tide them over, such as overdraft protection or payday loans.

A handful of financial technology startups have tried to provide real-time payment services, but they are limited networks, typically working only if both the sender and recipient are subscribers and/or have accounts at participating banks. Moreover, they still rely on legacy systems to settle funds between banks. This results in a buildup of obligations between sending and receiving banks, as the actual transfer of payments between banks can take several days. If allowed to grow, this complex

[25] Ibid.

[26] Ibid., p. 64: "Having [the Fed's] cost accounting practices periodically subject to independent testing would provide greater assurance that the Federal Reserve is complying with the Monetary Control Act."

of IOUs among banks is a potential source of fragility in our payments infrastructure that could present significant risks in times of stress.

In 2017, a group of large banks under the auspices of The Clearing House or TCH launched a real-time payments platform called the RTP Network. This network aspires to achieve the ubiquity lacking with FinTech initiatives. It requires participating banks to prefund a joint account that stands behind payment transfers. Debits and credits are tracked in a centralized ledger maintained by TCH. As yet, RTP has failed to gain significant traction, with relatively low volumes and few banks participating beyond mostly the big ones which own TCH. Importantly, its safety and resilience is heavily reliant on the larges banks which built and back it.

What's needed—but what the private sector has yet to deliver—is a trusted and universally available infrastructure that would allow banks and credit unions of all sizes to send and receive money in "real time". After years of study and public outreach, the Fed has now decided to develop and launch such a system: FedNow. The Fed is already connected to virtually every depository institution in the country and thus is well-positioned to provide the basic infrastructure to move money quickly between banks.

Not surprisingly, the Fed's decision has been widely applauded by smaller institutions and FinTechs, but roundly criticized by TCH and its advocates, who argue that FedNow will unnecessarily compete with the RTP Network and stifle innovation.

History has shown the folly of exclusively relying on big Wall Street banks for financial infrastructure. Indeed, one political catalyst for Congress creating the Federal Reserve System in 1913 was the inability of midwestern farmers to access funds during planting season. The large New York institutions rural banks then relied upon to keep their reserve deposits had a bad habit of lending those funds to securities speculators, instead of keeping them safe and readily accessible. Currently, nearly all major payments systems—including those for processing checks, facilitating direct deposits, and wire transfers—depend on both private and Fed systems.

Smaller depository institutions and FinTechs are understandably wary of a system controlled by big bank competitors. For now the TCH has promised its system will be accessible to all on fair and equitable terms, but will those promises hold in the future if they achieve market dominance? Until recently, the TCH website acknowledged its pricing could change if it has to "react competitively". The Federal Reserve lacks regulatory authority to require TCH to make its system accessible to everyone or regulate its fees to prevent anti-competitive pricing.

FedNow will promote competition, not stifle it, by protecting against potential anticompetitive behavior by TCH or any other dominant private actor of the future. The Fed wants private sector innovation. Indeed, it worked closely with TCH to set up the joint account which underpins the RTP Network. And it is exploring making its current wire and net settlement services available on a 24x7x365 basis to support private initiatives to provide faster payments around the clock. But the Fed wants multiple players in this space, competing on fair terms. With FedNow, it will give all depository institutions and their FinTech partners a ubiquitous infrastructure upon which they can build their own platforms and services.

Some critics have scoffed at the notion that "Government bureaucrats" at the Fed could come up with an innovative new system, and point to the fact that FedNow is not expected to launch until 2023 or 2024. Given the Fed's long history in payments, the expertise of the Fed's staff is unparalleled, while private sector innovation in this space has been sluggish. Work on the TCH system started in 2014. It did not go live until 3 years later, and TCH acknowledges that it will not be easily available to all depository institutions until the end of 2020. The widely used ACH system, which facilitates direct deposits, took 6 years to develop during the late 1960s and early 1970s, and even longer after it was developed to mature in its current widely used form. Four to five years does not seem like an inordinate amount of time to build FedNow, particularly given the Fed's commitment to work with all industry stakeholders and fully explore use of new technologies to construct the system.

Perhaps most importantly, FedNow will promote financial system resiliency. As we discovered in 2008, big banks can fail. The Fed cannot. The TCH has tried to construct a system that comes close to replicating central bank settlement, but it is not the Federal Reserve. We hope that postcrisis reforms will prevent the failure of large, systemic institutions in the future, but we cannot be sure. Only the Fed has the institutional capability and proven track record to operate under the most highly stressed conditions. Without a backup system, a failure to fund RTP's joint account by a major bank could impact continuity in payment services for millions of Americans. This could leave taxpayers with a conundrum similar to the one they faced in 2008: bail the banks out or expose households and businesses to disruptions in essential payment services. If the big banks were truly interested in the resiliency of the financial system—and rebuilding trust with the public—they would be applauding FedNow as a parallel system that could serve as a backup to their own. FedNow would also serve as an important backstop to potential operational breakdowns in the RTP system, including compromise of its centralized ledger.

Finally, while I strongly support the Fed's decision to build "FedNow" let me also express the hope that the Fed fully explores the use of digital currency, including a cryptocurrency based on distributed ledger technology (DLT), in effectuating real-time settlement between banks. As I have written in the past, the Fed should consider development of a Central Bank Digital Currency (CBDC) that could eventually be used by members of the public to transfer money directly between each other without the need for bank intermediation and its attendant costly fees. If based on DLT, such a system promises to be more secure, efficient and less costly than intermediated systems that rely on centralized ledgers and master accounts. Given the permanence and immutability of DLT, it could also provide important law enforcement benefits. In moving toward such a system, using DLT to support settlement between banks might be a good place to start.

Importantly, major private sector proposals, such as Facebook's recent proposal to create a new global cryptocurrency called "Libra" rely on DLT. Libra faces many roadblocks. However, even if the Facebook initiative fails, it certainly won't be the last private sector attempt to leverage DLT to dominate global payments. If the Fed does not stay ahead of this rapidly maturing technology, I fear private sector efforts to eclipse fiat monetary systems will get ahead of them, with potential disruptions to our banking system and in a worst case scenario, loss of control of our own currency. Since leaving the FDIC, I have become involved as a board member or advisor to a number of financial technology startups developing use cases for DLT ranging from securities to mortgages to gold to a stable coin tied to the dollar. While the promise of such technology is great, I am convinced that when it comes to payments, the Federal Reserve is in the best position to utilize it in a way that maximizes the public good.

Whether the threat comes from big banks or big tech, private interests should not dominate payments services so crucial to the financial well-being of the public. They should have the right to compete, but not monopolize, how we move our money. Only the Fed has the resources, expertise, and public mandate to build a payments system infrastructure that can capture the benefits of private innovation while ensuring a competitive playing field and most importantly, a stable system that will serve the public during good times and bad.

For the Committee's information, I have attached some of my previous writings on Facebook's Libra and the need for a CBDC.

I would be happy to answer the Committee's questions.

Attachments:

https://finance.yahoo.com/news/fed-libra-sheila-bair-160930832.html;
https://finance.yahoo.com/news/former-fdic-chair-fed-needs-get-serious-digital-currency-131756819.html

Why the Fed should oversee Facebook's Libra

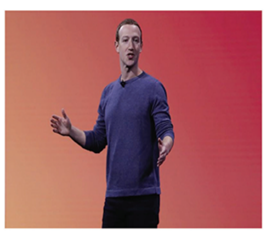
Sheila Bair
Contributor
Yahoo Finance
July 8, 2019

Facebook (FB) Mark Zuckerberg's recent announcement of ambitious plans to launch a new, global cryptocurrency called Libra has been met with understandable alarm, particularly among regulators and consumer advocates.

Much of the controversy has centered around antitrust issues, consumer privacy, and the ability of crooks to anonymously use the system for illicit purposes. Those are all legitimate concerns, but to my mind, the biggest risks are financial, both to users of Libra and the financial system as a whole. Those risks include the possibility of bank runs, credit disruptions, or consumer losses arising from foreign currency risks or financial mismanagement of the Libra reserve. The best way to understand these risks is to follow the money.

Buying and redeeming Libra

Let's start with the process of buying and redeeming Libra. Most cryptocurrencies, including the granddaddy of them all, Bitcoin, have failed to gain widespread acceptance as a method of payment because of their volatility. Zuckerberg hopes to avoid this problem by backing Libra with a reserve of stable world currencies, including the dollar, Euro, and Swiss franc. So you can buy Libra with pretty much any fiat currency — a U.S. dollar, Brazilian Real, Mongolian Tugrik, Indian Rupee — but the amount of Libra you receive will depend on the exchange rate between your currency and the basket of currencies in the reserve at the time of purchase. When you want to redeem your Libra back into your fiat currency, you may get more. But you may also get a lot less, particularly in developing countries with unstable currencies. It will depend on the exchange rate at the time of redemption.



Facebook CEO Mark Zuckerberg makes his keynote speech during Facebook Inc's annual F8 developers conference in San Jose, California, U.S., April 30, 2019. REUTERS/Stephen Lam

Let's say you still want to buy this hip new digital coin, regardless of the foreign exchange risk. Where do you get the money? For citizens in the U.S. and other developed countries, the money will probably come from your bank account. It's not going to hurt the banking system if you withdraw a few hundred a month for Libra transactions. But what if everyone decides they want to replace their bank accounts with Libra? After all, this would be a great way to avoid checking account fees. Retailers will love Libra as a way to avoid paying network fees on debit and credit card transactions. All of a sudden, that giant sucking sound is money coming out of the banks and into Libra's kitty.

You may think, "Fine. Let's stick it to the banks. Look what they did to the economy in 2008." But most of that money you withdraw from the banks is money they will no longer have to lend to the economy. So as Libra captures your cash, banks have less to make loans. With a run on the banks, we also get a credit contraction.

What happens after Libra has your money?

Now Libra has your money (not the banks) and you have your digital coins. What will Libra do with your money? Libra's white paper says your digital coin is safe because it will be backed by a basket of the most stable world currencies. But it's not as if Libra will be purchasing paper money in each of these currencies and piling them in a bank vault. What this really means is that Libra will be taking your money and investing it in instruments denominated in those currencies.

The return on these investments is how Facebook and other Libra founders will make money. Thus they will have incentives to invest in instruments that will maximize those returns, which may or may not maintain the stable value Libra's founders are promising. The white paper promises to invest in low volatility assets such as bank deposits and short-term government securities, using "investment grade" financial institutions as custodians. (Reminder: Lehman Bros had an "A" rating from Standard and Poor's before its collapse in 2008.) But there is no regulatory body to ensure that it does so, nor to require that Libra's sponsors put up any of their own capital or reserves to backstop those investments if they go sour.

People stand next to windows above an exterior sign at the Lehman Brothers headquarters in New York in this September 16, 2008 file photo. REUTERS/Chip East/Files (UNITED STATES BUSINESS EMPLOYMENT ANNIVERSARY) In essence, Libra proposes the failed business model used by money market funds prior to the financial crisis. It wants you to buy Libra on the promise that the coin will maintain stable value, but there will be no regulatory oversight of what Libra actually does with your money and no capital and liquidity requirements that you would typically find with a bank. That structure proved disastrous during the 2008 crisis, when the Reserve Fund, a money market fund that heavily invested in Lehman Bros debt, "broke the buck" and prompted widespread runs on other money market funds.

A big re-allocation of resources

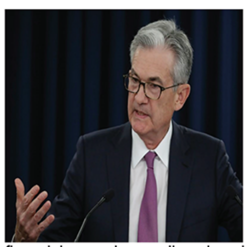
Even if Libra keeps its promise to put your money only in relatively safe bank deposits and government securities, we still have a problem. If the money comes out of banks (where it supports private sector lending) and goes into government securities, we would see a massive re-allocation of resources from the private to the public sectors. If you believe (as do I) that the market is generally a better allocator of economic resources than the government, this re-allocation will serve as a drag on economic growth.

Libra says it will also put your money into bank deposits. Bank accounts have the advantage of maintaining stable value. Your bank account balance doesn't fluctuate as would a securities investment. And perhaps this helps with our bank run problem. You take money out of your bank to buy Libra. Libra puts yours and other users' money into other banks, which will presumably use it to make loans.

But banks do fail, and depositors take losses on their uninsured deposits. So while Libra is saying it's offering a better alternative to banks because it won't be taking risk by lending out your money the way banks do, it will be putting at least some of your money right back into banks of its choosing. When you withdrew money from your bank to buy Libra, you probably had less than $250,000 in your account, meaning it was fully protected by the FDIC. But Libra's founders hope to have a global reserve of hundreds of billions of dollars. Even if they spread the funds among multiple banks, at those levels, the lion's share will likely be uninsured.

The need for regulation

Anyone who has followed my writings on blockchain knows that I'm enthusiastic about the use of distributed ledger technology to remove frictions in the payments system. So I don't mean to sound too negative. The problem is, so long as cryptocurrencies have to rely on fiat currencies to maintain stable value, they will be exposed to the same kinds of risks embedded in the banking systems that support those currencies. I believe most of these risks can be addressed with thoughtful regulation. But before Mark Zuckenberg or anyone else tries to create his own global currency, we need to settle on an adequate regulatory framework to govern them.



WASHINGTON, DC - JUNE 19: Federal Reserve Board Chairman Jerome Powell speaks during a news conference after the attending the Board's two-day meeting, on June 19, 2019 in Washington, DC. Powell said the Fed will keep rates steady and hinted at a possible rate cut later in the year. It would make sense for Congress to give the Federal Reserve Board lead authority for overseeing Libra, given its responsibility to conduct monetary policy and oversee an effective and efficient payments system. It is also an experienced financial supervisor, well-equipped to develop capital and liquidity requirements for Libra and other such ventures. In exercising that authority, the Fed could build on the pioneering work of the New York Department of Financial Services which currently regulates two trust companies which have successfully launched stable coins backed by the U.S. dollar. (Disclosure. I serve on the board of one of those trusts, Paxos.)

Technology has the potential to dramatically change how the world pays for things in the future. Whether that transition is beneficial to consumers and businesses or financially disruptive will depend on whether regulators can stay ahead of this potentially rapid transformation. It's open to question whether Mark Zuckerberg and Facebook are the right stewards for a new global cryptocurrency. But by firing this warning shot to government policy makers that such a change is coming and potentially coming soon, they have done a public service.

Sheila Bair is the former Chair of the FDIC and has held senior appointments in both Republican and Democrat Administrations. She currently serves as a board member or advisor to a several companies and is a founding board member of the Volcker Alliance, a nonprofit established to rebuild trust in government.

Former FDIC chair: The Fed needs to get serious about its own digital currency

Sheila Bair
Contributor

Yahoo Finance June 21, 2018

NOTE: This post was originally published on June 8, 2018.

Last week's market volatility reminds us — again — of the fragility of modern-day financial systems. In just the past decade, we've experienced our own subprime crisis, followed by Europe's sovereign debt crisis, followed by assorted calamities in Portugal, Venezuela, Russia, Ukraine, Brazil, and now the risk of Italy exiting the Eurozone.

Lack of confidence in our banking systems motivated the mysterious Satoshi Nakamoto to develop bitcoin. He (she, they?) originally intended it as a widely accepted method of payment that could function completely outside of the banking system. Unfortunately for M. Nakamoto, bitcoin has failed miserably as a method of payment. Its extreme volatility has made it popular as a speculative investment and store of value, but who wants to pay for something in bitcoin when its value could double in a month, or accept it as payment if its value could just as precipitously drop?

A radical idea that's gaining credibility

But what if the Fed or other central bank issued their own digital money? Though it sounds radical, the idea is gaining credibility among an increasing number of mainstream economists and central bankers themselves. Presumably, a central bank-issued digital currency (CBDC) would be as stable as traditional fiat currency, while reducing the risk of financial crises and improving monetary policy tools. To be sure, a sudden, wholesale shift from bank accounts to CBDC could have severely negative consequences for credit availability given banks' reliance on deposits to fund loans.

Former FDIC director Sheila Bair on Capitol Hill in Washington June 26, 2013. REUTERS/Yuri Gripas

Consider the current bank-dominated payments system. Institutions and individuals place most of their ready cash with banks, either through deposit accounts (a portion of which is FDIC insured) or by purchasing banks' short-term debt. The system works smoothly under benign conditions, but in times of extreme stress, people lose confidence in their banks. So they pull their uninsured money out of the banking system, disrupting the free flow of payments. This problem of "bank runs" is as old as banking itself, and has yet to be fully conquered, notwithstanding the advent of deposit insurance.

However, suppose consumers and businesses could convert their bank deposits into a digital currency that would be issued and backed by the Fed? Let's call it FedCoin. They would no longer need to worry about bank instability. Since the Fed can print its own money, by definition, it can always make good on its financial obligations. What's more, the costs and inefficiencies in the current payments system would be greatly reduced. Consumers would no longer need to maintain checking accounts, with their expensive maintenance and overdraft fees, to effectuate payments. At the same time, businesses accepting Fedcoin could avoid the interchange fees charged by banks and their card networks — fees that are particularly burdensome to small firms.

A better tool to conduct monetary policy

Importantly, the Fed would have much more effective tools for conducting monetary policy to address economic cycles. The Fed now manipulates the money supply through buying and selling securities with a select group of big banks and by paying them interest on the reserves they deposit at the Fed — currently a tidy 1.75%. When the Fed wants to stimulate the economy — as it did after the crisis — it buys securities from these banks and reduces the rates it pays them on reserves, inducing them to lend the proceeds to the real economy to get a better return. When it wants to raise rates — as it is doing now — it reduces its holdings of securities and increases the rates it pays on reserves.

This is a nice deal for the banks, but hasn't done a whole lot to help the rest of us. The past 10 years are proof positive that current monetary tools are woefully inadequate to stimulate broad-based economic growth. The super rich have gotten a lot richer, while the middle class has struggled.

But imagine that we all held interest-bearing FedCoin. During inflationary periods when the economy is overheating, the Fed could raise rates on interest which would be paid directly to the general public, giving us an incentive to put more savings into FedCoin and spend less. During recessionary periods, the Fed could reduce the interest rate on that currency, giving us more incentive to spend to stimulate economic growth. If the Fed reduced rates to zero and the economy still spiraled downward, it could issue special digital coins that would disappear, within a time certain, if not spent on consumption. This would be much more effective stimulus than the deficit-funded tax and Social Security refunds we employed during the Great Recession. Instead of spending that money, most people either saved it or paid down existing debt.

Why the Fed needs to stay ahead of this technology

This may sound like monetary nirvana, yet FedCoin could have major disadvantages as well. The biggest is disruption to credit availability. Over $10 trillion is currently deposited in demand deposit accounts with banks. This is money banks use to lend to consumers and businesses, but could theoretically disappear if the public moved their all of their bank transaction accounts into FedCoin. Yet, this risk could be mitigated by limiting the amount of FedCoin issued and allowing banks to compete with FedCoin for deposits (though they might have to offer better rates and service to do so).

Many central banks — including those in the UK, Singapore, China, and Sweden — are proactively evaluating the merits of a central bank-issued digital currency. Meanwhile, tech geniuses in the private sector have not given up on Nakamoto's original vision to create a privately issued, stable digital currency that could be widely used for payments. Perhaps the most well-publicized effort is Basis, a startup backed by such luminaries as billionaire investor Stanley Druckenmiller and highly regarded former Federal Reserve Governor Kevin Warsh. Basis's algorithm stabilizes its value by issuing more of the currency when the price goes up relative to the dollar, and buying it back when the price declines.

It is far from certain whether Basis or similar private sector efforts will be successful, at least in the short term. However, think of the ramifications if they were. Retailers, large and small, loathe paying interchange fees on card transactions, as much so as consumers hate getting trapped in high account fees. One can imagine they would be eager to start using digital currency as payment, bypassing the banks. That could prompt a different kind of run on banks, as fiat money quickly migrated out of deposit accounts into digital coins.

That would be very bad for the banking system, but also the Fed, as its current monopoly on currency issuance would be threatened, as would its ability to control the money supply. To avoid that result, the Fed needs to get serious now about evaluating the relative merits of issuing its own digital currency. If it does not stay ahead of this technology, not only could banking be disrupted — but the Fed itself could also be at risk.

Sheila Bair is the former Chair of the FDIC and has held senior appointments in both Republican and Democrat Administrations. She currently serves as a board member or advisor to a several companies and is a founding board member of the Volcker Alliance, a nonprofit established to rebuild trust in government.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR BROWN FROM ESTHER GEORGE

Q.1. How is the Federal Reserve's decision to implement real-time payments consistent with its historic role in the payment system?

A.1. A new Federal Reserve service to support faster payments, operating alongside private-sector real-time gross settlement (RTGS) services for faster payments, aligns with the current model for most other payment systems in the United States. Since its inception, as intended by Congress, the Federal Reserve has played a key operational role in the Nation's payment system by providing payment and settlement services between banks. Over the last 100 years, this operational role has allowed the Federal Reserve to advance key policy goals that support the Federal Reserve's broader mission, such as the accessibility, safety, and efficiency of the U.S. payment system. The payment and settlement services offered by the Reserve Banks, such as services for funds transfers, checks, and automated clearinghouse (ACH) payments, have traditionally operated alongside and in support of similar private-sector services. Through the decision to develop the FedNowSM Service, the Federal Reserve will continue to serve its traditional role of providing payment and settlement services to banks and will help establish a safe and efficient nationwide infrastructure for faster payments in the United States.

Q.2. During the hearing, Mr. Hunter testified that the regulatory authority the Federal Reserve has over a bank that they supervise is the same regulatory authority that they have over The Clearing House. Is this characterization accurate?

Please explain the distinction between the Federal Reserve's authority over State-chartered member banks and its authority over payments system operators like TCH.

A.2. The Federal Reserve Board (Board) has examination and enforcement authority over State member banks under section 9 of the Federal Reserve Act and section 8 of the Federal Deposit Insurance Act (FDIA), and can examine all aspects of their operations. Its enforcement tools for these banks include cease and desist orders, written agreements, prompt corrective action directives, removal, and prohibition orders, and orders assessing civil money penalties.

The Board does not have plenary regulatory or supervisory authority over the U.S. payment system. Some payments system operators, such as The Clearing House (TCH), are examined by the Board, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency (the agencies) under the Bank Service Company Act (BSCA). The BSCA provides the agencies with the authority to examine and regulate (but not take enforcement actions against) a firm that provides certain services to supervised institutions. This authority is limited to any services authorized by the BSCA that the firm provides to a depository institution, or any subsidiary or affiliate of such depository institution.

In addition, the Board is the supervisory authority for TCH in its role as the operator of the Clearing House Interbank Payments System, as a designated financial market utility under Title VIII of the Dodd–Frank Wall Street Reform and Consumer Protection

Act of 2010. Pursuant to this authority, the Board can, among other things, examine TCH, prescribe risk management standards, and receive and review advance notice of proposed changes to the operations of TCH. This authority, however, does not apply with respect to TCH's role as the operator of other payment systems, such as its system for faster payments.

Q.3. How will the liquidity management tool and expanded hours for Fedwire Funds Service and the National Settlement Service benefit banks and private-sector payment operators, including TCH?

What actions has the Federal Reserve already taken to support private sector developments and the existing private-sector RTP system?

A.3. Over the past 6 years, the Federal Reserve and industry stakeholders have collaborated on a number of initiatives to improve the speed, safety, and efficiency of the Nation's payment system. In 2015, the Federal Reserve convened the Faster Payments Task Force, a 320-member group comprised of a broad range of industry stakeholders, to identify and assess alternative approaches for implementing safe and ubiquitous faster payment capabilities in the United States. The Federal Reserve also has directly supported the development of private-sector services for faster payments by providing joint accounts to facilitate settlement in faster payment services. For example, the faster payment service offered by TCH settles payments in real time on its private ledger, supported by a joint account at a Reserve Bank that is prefunded by banks participating in the service.

Expanded Fedwire Funds Service and National Settlement Service (NSS) hours would support a wide range of payment activities, including private-sector RTGS services for faster payments. In particular, the Reserve Banks do not currently offer a service that provides the functionality to manage liquidity on a 24x7x365 basis for RTGS services that rely on a joint account. The ability to transfer funds from master accounts at the Reserve Banks to a joint account on a 24x7x365 basis would allow participants in such services to manage liquidity more effectively, avoiding the need for additional funding of a joint account ahead of times when liquidity transfers are not currently possible, such as weekends and holidays. By expanding Fedwire Funds Service and NSS hours, the Federal Reserve would provide further support to private-sector RTGS services for faster payments based on joint accounts. Expanded hours for the Fedwire Funds Service and NSS could also benefit other retail or wholesale payment activities, for example, by enabling additional settlement windows for ACH payments.

Q.4. How will faster payments benefit lower income workers and small businesses?

A.4. Beyond speed and convenience, faster payments can yield real economic benefits for individuals and businesses, including lower-income workers and small businesses, by allowing them to make time-sensitive payments whenever needed and providing them with more flexibility to manage their money. This flexibility is especially important for individuals and households on tight budgets, for whom receiving a payment in real time could help avoid the need to use expensive check cashing services, engage in high-cost borrowing, or incur overdraft or late fees, which may represent a significant financial burden. Similarly, immediate access to funds and the ability to make bill and invoice payments instantly can benefit small businesses that may otherwise need to seek costly short-term financing. Widely available faster payments would be the foundation for the next generation of payment services, catalyzing innovations that generate new economic activity.

Q.5. The Federal Reserve anticipates the FedNow Service to be available in 2023 or 2024. What is your process for developing and building this new system?

To what extent is industry and public feedback factored into this timeline?

A.5. The Federal Reserve recognizes that establishing the FedNow Service will need to be carried out as soon as practicably possible and that time-to-market is an important consideration for many industry participants. As part of the process for developing the FedNow Service, the Board requested public comment on the service's desired features and functionality.[1] The Federal Reserve has engaged with industry participants through one-on-one meetings, industry forums, and presentations to facilitate and encourage those comments. The public comment period ended on November 7, 2019. All comments will be carefully and thoroughly reviewed. Following this, the Board will publish a final service description in an upcoming *Federal Register* Notice. In addition, the Federal Reserve will continue to engage with industry stakeholders, the public and Congress, throughout the development process for the FedNow Service in order to understand and address, on an ongoing basis, the needs of depository institutions, other industry stakeholders, and the public.

Q.6. I have been concerned about private entities like Facebook introducing digital currencies as an alternative to the U.S. dollar or other fiat currencies. What are the risks to the financial system if there are private digital currencies competing with the U.S. dollar?

Please provide historical examples.

A.6. History provides many experiences to draw on for assessing proposals for private money, from the period in our history when the colonial States each issued their own currencies to the many decades when the circulation of private commercial banknotes stood in for a national currency. The Federal Reserve was created in part to respond to the inability of many of these banks to honor their obligations for the banknotes they issued and the panics and runs that ensued. Those experiences inform how we think about current innovations in payments and potential new forms of private money.

The existing financial system combines central bank money, commercial bank money, and certain nonbank private money based on the U.S. dollar as the unit of account. Central bank money is composed of paper currency and money held in deposits at the Federal Reserve Banks. Commercial bank money refers to money held in

[1] The *Federal Register* Notice is available at *https://www.federalreserve.gov/newsevents/pressreleases/files/other20190805a1.pdf.*

deposits at commercial banks. Commercial bank money is widely used in part because people are confident that they can convert it on demand to the liability of another commercial bank or of the central bank, such as physical cash. This confidence comes in no small part because bank deposits are insured, and commercial banks are subject to supervision and regulation. Consumers and businesses also use this money in transactions because of its convenience and availability.

Nonbank private money based on the U.S. dollar as the unit of account exists in smaller scale for a variety of consumer uses, including payments (e.g., Paypal) and general purpose stored value cards. The current diverse set of retail payment options available to consumers is provided by a variety of partnerships between nonbank private payment companies and commercial banks (e.g., card networks). Various Federal and State laws regulate private nonbank money and establish consumer protections for their users. Nonetheless, the corporate issuers of nonbank private money are not regulated to the same extent as are banks, the value stored in these systems is generally not FDIC insured, and consumers may be at risk that the company issuing such money will not be able to honor these liabilities.

Facebook's Libra initiative stands out from the above types of money in a variety of ways, including potential scale, cross-border ambitions, and its intention to create its own denomination. The Libra initiative belongs to a diverse class of products called stablecoins. Many stablecoins aspire to serve as a new technological iteration of either commercial bank or nonbank private U.S. dollars, while others, like Libra, aspire to establish a separate unit of account. Facebook has stated that its use of a separate denomination is not meant to rival existing fiat currencies but to reduce cross-border payments frictions through the use of a single unit of account. Regardless of their potential use cases, it is important that Libra and similar projects address a core set of legal and regulatory issues before processing payments. Compliance with customer due diligence over anti–money-laundering rules and regulations will be essential to ensure Libra is not used for illegal activities and illicit finance. Facebook and/or the Libra Association should clearly demonstrate how consumer protections would be assured.

Consumers should be educated on how their rights differ with respect to digital wallets compared to bank accounts. Additionally, Facebook and/or the Libra Association should provide clarity on what legal entity can be held responsible for the security of personally identifiable information and transaction data, and clarity on how and by whom personal data will be stored, accessed, and used.

More broadly, Libra or similar large-scale initiatives raise questions regarding the ways they will link to the banking system or other financial institutions, which specific financial activities will be conducted by the envisioned payment network and broader services ecosystem, and what potential broader impacts these initiatives might have on the implementation of monetary policy and the preservation of financial stability. If not managed effectively, liquidity, credit, market, or operational risks—alone or in combination—could trigger a loss of confidence and a classic run out of

Libra. A global network raises complicated issues associated with many legally independent but interdependent operations, and the lack of clarity about the management of reserves and the rights and responsibilities of various market participants in the network.

Guided by public and private cooperation, the U.S. payment system has evolved greatly to better serve all participants in the economy. Innovations and reforms have ushered in greater convenience in many ways, not least of which in the way individuals and institutions conduct transactions between and among themselves. As we continue to evaluate innovations in payments, including those that potentially include issuance of private, nondollar, digital currencies, we will continue to press for responsible innovation that contributes to the safety and efficiency of the payment system. Technology and innovation hold potential to improve the financial system and reduce frictions and delays, while also preserving consumer protections, data privacy and security, financial stability, and monetary policy transmission and guarding against illicit activity and cyber risks.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR TOOMEY FROM ESTHER GEORGE

Q.1. During the hearing, you confirmed that the Fed had not identified a specific pricing structure for FedNow. Why hasn't the Fed committed to a flat pricing structure such that institutions of all sizes are charged the same fees regardless of transaction volume? Please describe how a variable pricing structure could benefit depository institutions, especially small community banks and credit unions.

A.1. The Federal Reserve will announce the fee structure and schedule for the FedNowSM Service before the service is launched. To be responsive to the evolving needs of participants in the faster payment market, the Federal Reserve will perform an assessment of market practices at the time of service's implementation, and that assessment will inform the ultimate fee structure and schedule. Additionally, the Federal Reserve reviews its fees on an annual basis and revises them if necessary. As part of that annual process, the Federal Reserve publishes fee schedules in a *Federal Register* Notice.

For existing services, the Federal Reserve has used a variety of pricing structures, including volume-based pricing. The provision of payment services often involves large fixed costs. In such a situation, volume-based pricing structures can yield lower prices for service participants. Volume-based pricing can help encourage use of the service. If a payment service has high volumes, the fixed costs of providing the service can be spread among those many transactions, resulting in lower fees for all. Without such a pricing structure to encourage use, fixed costs would be distributed among lower volumes, increasing fees for all users of the service. The Federal Reserve therefore has used multiple pricing approaches to enable it to offer lower fees for all service users, including community banks and credit unions.

Q.2. If the Federal Reserve launches a real-time payments network that is not interoperable with those already in existence, the

United States will face a fragmented real-time payments system. The requirement for banks to incur additional costs to connect account holders to multiple networks will likely introduce costly inefficiencies that will be borne by financial institutions, businesses, consumers, and taxpayers. Should the Federal Reserve avoid fracturing our country's real-time payments system infrastructure by ensuring that its FedNow network is interoperable with all other real-time payments networks before launch?

A.2. The U.S. payment system must reach over 10,000 depository institutions across the Nation, an outcome that the Federal Reserve views as a key objective for the real-time gross settlement (RTGS) infrastructure for faster payments. Achieving such nationwide reach has been a recurring challenge, and, to date, no single private-sector payment service provider of traditional payment services, such as check, automated clearinghouse (ACH), funds transfer, or payment card services, has done so alone. By helping the RTGS infrastructure achieve nationwide reach through interoperability or other approaches, the FedNow Service can improve efficiency by increasing innovation and competition in the market for end-user faster payment services. In addition, the presence of multiple RTGS services for faster payments—the FedNow Service and private-sector RTGS services—can yield additional efficiency benefits by leading to lower prices and higher service quality, which would benefit the U.S. payment system and its users.

Through its engagement with the industry, the public, and Congress, the Federal Reserve is exploring interoperability and other paths to achieving the ultimate goal of nationwide reach for faster payments. Interoperability will continue to be a focus of the Federal Reserve's efforts.

Q.3. Do you believe the Federal Reserve has competitive advantages over private payment system operators?

If so, please describe them. If not, please explain why you believe there is a level playing field between the Federal Reserve and other payment system operators.

A.3. The Federal Reserve Board (Board) has recently published a *Federal Register* Notice that includes an initial competitive impact analysis, a typical practice when the Reserve Banks are considering an operational or legal change to a new or existing service, such as the planned FedNow Service.

In conducting its initial competitive impact analysis, the Board identified relevant private sector providers of similar services, and the Board then compared those providers' services with the FedNow Service to identify differences. The Board identified various differences between the FedNow Service and the private-sector RTGS that may construe relative advantages and disadvantages that benefit one service or the other. The Board requested public comment on its initial competitive impact analysis from August 5 to November 7, 2019. The Board will carefully review and consider all comments before issuing a final *Federal Register* Notice.

Q.4. In its January 2015 report titled "Strategies for Improving the U.S. Payment System", the Federal Reserve Board said it looked forward to exploring "the technology, infrastructure and operational and resource changes required to support weekend and/or

24x7 operating hours" for its National Settlement Service, which could allow all check and ACH payments to settle within a day. Why has the Federal Reserve chosen to focus its efforts on launching FedNow, which will take several years to implement, when it could much more quickly advance faster payments by expanding the hours of its existing National Settlement Service?

A.4. In January 2015, the Federal Reserve expanded National Settlement Service (NSS) operating hours to accommodate new rules for the posting and settlement of check and automated clearinghouse (ACH) payments.[1] More recently, in a May 2019 *Federal Register* Notice, the Federal Reserve Board sought public comment on potentially expanding further the operating hours of NSS and the Fed wire Funds Service to allow for a third same-day ACH processing and settlement window, which could result in increased adoption and use of same-day ACH payments.[2]

Both the FedNow Service and potential modifications to further support the ACH system through upgrades to existing services are part of the Federal Reserve's continued efforts to improve the U.S. payment system. In these efforts, the Federal Reserve will continue to evolve its existing services. In particular, the Federal Reserve is exploring the expansion of Fedwire Funds Service and NSS hours, up to 24x7x365, to facilitate liquidity management in private sector RTGS services for faster payments and to support a wide range of payment activities, beyond those related to faster payments.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR WARREN FROM ESTHER GEORGE

Q.1. What are the implementation challenges associated with FedNow? How does the Federal Reserve (the Fed) plan to resolve these challenges?

A.1. The United States has a highly complex banking system with more than 10,000 diverse depository institutions, including commercial banks, savings banks, savings and loan associations, and credit unions. This diversity inherently creates challenges with achieving nationwide reach, an outcome that the Federal Reserve views as a key objective for the real-time gross settlement (RTGS) infrastructure for faster payments. Achieving such nationwide reach has been a recurring challenge, and, to date, no single private-sector payment service provider of traditional payment services, such as check, automated clearinghouse (ACH), funds transfer, or payment card services, has done so alone. The Federal Reserve plans to leverage its existing nationwide infrastructure to provide a key channel to reach institutions across the country that might otherwise not have access to an RTGS infrastructure for faster payments. In advance of the service's launch, the Federal Reserve will be working closely with depository institutions and their technology partners to prepare for expeditious onboarding. Nevertheless, achieving nationwide reach of an RTGS infrastruc-

[1] The notice is available at *https://www.govinfo.gov/content/pkg/FR-2014-12-05/pdf/2014-28664.pdf.*

[2] The notice is available at *https://www.federalregister.gov/documents/2019/05/16/2019-09949/potential-modifications-to-the-federal-reserve-banks-national-settlement-service-and-fedwire-funds.*

ture for faster payments will take time, as the industry takes steps to adopt the FedNowSM Service and private-sector RTGS services. The Federal Reserve intends to work with the industry to resolve implementation challenges and to connect with the majority of institutions in the country, in furtherance of the ultimate objective of nationwide reach.

Q.2. In your testimony, you stated that the FedNow service would allow the Fed to "promote the development and implementation of industrywide fraud mitigation standards." Can you provide more detail regarding the steps being taken to prevent consumer harm from fraud on FedNow?

A.2. The Federal Reserve is actively engaging with industry stakeholders to better assess potential features of the FedNow Service that could help mitigate fraud risk and advance the safety of faster payments in the United States. For example, the FedNow Service could offer tools to help banks detect fraudulent payments. Following analysis of comments received from the public comment period that ended on November 7, 2019, the Board will elaborate on these features in a final service description, which will be provided in an upcoming *Federal Register* Notice.

Q.3. How will the Fed ensure that its system is fully interoperable with existing RTP systems and future ones that may develop?

A.3. The Federal Reserve views nationwide reach as a key objective for the RTGS infrastructure for faster payments and has considered the possible relationships between the FedNow Service and private-sector RTGS services. As mentioned previously, achieving nationwide reach has been a recurring challenge, and, to date, no single private-sector provider of traditional payment services, such as check, automated clearinghouse (ACH), funds transfer, or payment card services, has done so alone. Through its engagement with the industry, the Federal Reserve is exploring interoperability and other paths to achieving the ultimate goal of nationwide reach for faster payments. Interoperability will continue to be a focus of the Federal Reserve's efforts.

Q.4. In the *Federal Register* notice for the proposed FedNow Service, the Fed also announced plans to explore expanding the hours for the Fedwire Funds Service and the National Settlement Service. [1]

Does the Federal Reserve have a timeline for implementing this proposed expansion?

A.4. Because of the Federal Reserve Board's (Board) risk management expectations for the Fedwire Funds Service, additional analysis is needed to evaluate fully the relevant operational, risk, and policy considerations for both the Reserve Banks and a large number of service participants, with a range of needs and objectives. The Federal Reserve plans to engage with the industry on issues related to expanded Fedwire Funds Service and National Settlement Service (NSS) operating hours, as well as potential approaches for expanding those hours. Subject to the outcome of this

[1] Federal Reserve System, *Federal Register* Notice, "Federal Reserve Actions To Support Interbank Settlement of Faster Payments", August 9, 2019, *https://www.federalreserve.gov/newsevents/pressreleases/files/other20190805a1.pdf*.

engagement, as well as additional analysis of relevant operational, risk, and policy considerations, the Board will seek public comment on plans to expand hours for the Fedwire Funds Service and NSS.

Q.5. Please describe the ways in which this expansion will further support private sector initiatives to provide faster payments and more quickly settle transactions.

A.5. Expanded Fedwire Funds Service and NSS hours would support a wide range of payment activities, including private-sector RTGS services for faster payments. In particular, the Reserve Banks do not currently offer a service that provides the functionality to manage liquidity on a 24x7x365 basis for RTGS services that rely on a joint account at a Reserve Bank. The ability to transfer funds from master accounts at the Reserve Banks to a joint account on a 24x7x365 basis would allow participants in such services to manage liquidity more effectively, avoiding the need for additional funding of a joint account ahead of times when liquidity transfers are not currently possible, such as weekends and holidays. By expanding Fedwire Funds Service and NSS hours, the Federal Reserve would provide further support to private-sector RTGS services for faster payments based on joint accounts. Expanded hours for the Fedwire Funds Service and NSS could also benefit other retail or wholesale payment activities, for example, by enabling additional settlement windows for ACH payments.

Q.6. The Fed has stated that the ultimate pricing structure for FedNow "would be informed by the Board's assessment of market practices at the time of implementation."[2] Could you provide further detail as to what factors the Fed will be considering as it develops a fee structure and schedule, particularly with respect to whether the Fed will offer volume discounts to the largest banks?

A.6. The Federal Reserve will announce the fee structure and schedule for the FedNow Service before the service is launched. To be responsive to the evolving needs of participants in the faster payment market, the Federal Reserve will perform an assessment of market practices at the time of service's implementation, and that assessment will inform the ultimate fee structure and schedule. Additionally, the Federal Reserve reviews its fees on an annual basis and revises them if necessary. As part of that annual process, the Federal Reserve publishes fee schedules in a *Federal Register* Notice.

For existing services, the Federal Reserve has used a variety of pricing structures, including volume-based pricing. The provision of payment services often involves large fixed costs. In such a situation, volume-based pricing structures can yield lower prices for service participants. Volume-based pricing can help encourage use of the service. If a payment service has high volumes, the fixed costs of providing the service can be spread among those many transactions, resulting in lower fees for all. Without such a pricing structure to encourage use, fixed costs would be distributed among lower volumes, increasing fees for all users of the service. The Federal Reserve therefore has used multiple pricing approaches to en-

[2] Ibid.

able it to offer lower fees for all service users, including community banks and credit unions.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR SINEMA FROM ESTHER GEORGE

Q.1. According to the Federal Reserve (Fed), FedNow will be able to leverage the Fed's existing network and infrastructure to achieving nationwide reach. However, joining FedNow will not only depend on existing infrastructure but the cost of connecting to the system. Can you provide any insight into pricing and how the Fed will ensure a level playing field for smaller financial institutions, such as community banks?

A.1. Historically, driven by its longstanding policy commitment to promote nationwide access to payment services, the Federal Reserve has provided services to banks of all sizes on fair and equitable terms, including smaller banks in rural and remote areas of the country. The FedNowSM Service will facilitate access to a real-time gross settlement (RTGS) infrastructure for faster payments for these banks and, most importantly, the communities they serve.

In assessing fees for new and existing services, the Federal Reserve evaluates customer needs, while recognizing longstanding principles for the pricing of Federal Reserve services and the requirement of the Monetary Control Act of 1980 that, over the long run, fees shall be established on the basis of all direct and indirect costs incurred in providing the services. [1] In order to make payment services available to banks in a fair and transparent manner, the Federal Reserve reviews fees on an annual basis and revises them if necessary, in addition to making all fee schedules available publicly to customers and competitors alike. [2]

Before the FedNow Service is launched, the Federal Reserve will assess market practices to inform the service's fee structure and schedule and will provide the fee schedule to the public. Following the launch of the service, the Federal Reserve will continue to assess evolving conditions in the market and will respond accordingly as part of its annual review of priced services.

Q.2. According to the Fed, interoperability may not be an initial element of FedNow. However, there are growing concerns that a lack of interoperability at the onset will lead to a fragmented payments system, where smaller institutions will be unable to join FedNow because they have already dedicated resources to connecting to another real-time system. What steps is the Fed taking to mitigate a fragmented system?

A.2. The U.S. payment system must reach over 10,000 depository institutions across the Nation, an outcome that the Federal Reserve views as a key objective for the RTGS infrastructure for faster payments. Achieving such nationwide reach has been a recurring challenge, and, to date, no single private-sector provider of traditional payment services, such as check, automated clearinghouse

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[1] The pricing principles are available at *https://www.federalreserve.gov/paymentsystems/pfs_principles.htm.*

[2] The 2019 fee schedule is available at *https://www.federalregister.gov/documents/2019/02/01/2019-00624/federal-reserve-bank-services.*

(ACH), funds transfer, or payment card services, has done so alone. By helping the RTGS infrastructure achieve nationwide reach through interoperability or other approaches, the FedNow Service can improve efficiency by increasing innovation and competition in the market for end-user faster payment services. In addition, the presence of multiple RTGS services for faster payments—the FedNow Service and private-sector RTGS services—can yield additional efficiency benefits by leading to lower prices and higher service quality, which would benefit the U.S. payment system and its users.

Through its engagement with the industry, the Federal Reserve is exploring interoperability and other paths to achieving the ultimate goal of nationwide reach for faster payments. Interoperability will continue to be a focus of the Federal Reserve's efforts.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR BROWN FROM ROBERT HUNTER

Q.1. One third of The Clearing House's owners are foreign banks, and the RTP system is based on technology developed and owned by a U.K. payments company. What data security protocols does TCH use to protect the RTP system from a data breach or infiltration by a foreign actor? What cloud services, if any, does TCH use?

A.1. The Clearing House (TCH) takes data security extremely seriously and maintains a critical and constant emphasis on the safety, security, reliability, and efficiency of our payment systems. This commitment is evident in TCH's remarkable 166-year history of reliability and resiliency, having maintained our operations without interruption through multiple world wars, financial crises, natural and man-made disasters, including 9/11 and the great recession, and a host of cybersecurity threats.

Importantly, TCH is supervised and regulated to the highest standards of information security protection by the Federal Reserve, the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency under the Bank Service Company Act and through the Significant Service Provider (SSP) program. [1] Through the Bank Service Company Act, the SSP program, and other authorities, TCH is subject to voluminous standards and guidance relating to information security promulgated by the Federal Financial Institutions Examination Council. In addition to regulation and supervision under the SSP program, TCH has also been designated as a systemically important financial market infrastructure and is regulated and supervised by the Federal Reserve pursuant to Title VIII of the Dodd–Frank Act. [2]

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[1] The agencies' authority under the Bank Service Company Act is quite broad. See, e.g., 12 U.S.C. 1867 (c) ("whenever a depository institution that is regularly examined by an appropriate Federal banking agency or any subsidiary of or affiliate of such depository institution that is subject to examination by that agency causes to be performed for itself, by contract or otherwise, any services authorized under this chapter, whether on or off its premises such performance shall be subject to regulation and examination by such agency to the same extent as if such services were being performed by the depositary institution itself on its own premises"); 12 U.S.C. 1867 (d) ("The Board and the appropriate Federal banking agencies are authorized to issue such regulations and orders as may be necessary to enable them to administer and to carry out the purposes of this chapter").

[2] While The Clearing House's regulation and supervision under Title VIII relates specifically to its role as the operator of CHIPS, the exam team frequently takes the view that their super-

Continued

In order to protect the security and integrity of the RTP® network, TCH employs a state-of-the-art, multitier, multisite application architecture with robust security controls and industrial-strength resiliency to protect the confidentiality, integrity, and availability of real-time payments, messages, and associated data. TCH systems and protocols are compliant with the highest Government, financial, and technology industry standards (NIST, FFIEC, ISO). All payments and related data are transmitted over private network communications lines only, data is encrypted both in transit and at rest and TCH does not employ any cloud services in the RTP® network architecture. Systems are continuously and regularly monitored for vulnerabilities, with real-time alerting and reporting features. TCH is also in regular contact with the Federal Bureau of Investigation, the Internet Crime Complaint Center, the National Cyber Investigative Joint Task Force, FS–ISAC, and FSARC to help facilitate coordination and communication relating to information security events.

We also note that the technology provider for the RTP network, Vocalink, while headquartered in the United Kingdom, is owned by MasterCard, a U.S. company. Vocalink does not run the RTP network and does not receive any transactional data. All code provided by Vocalink is scanned by TCH for potential viruses and anomalies and PEN tested before being placed in production. Production code for the RTP network runs on TCH servers located in the United States.

Finally, we note that while banks that are chartered outside of the United States may become members of TCH, they must have powers in their home jurisdiction similar to those of the domestic commercial banks or trust companies that are otherwise eligible for membership in TCH and must have a branch or agency located within the United States licensed by the Comptroller of the Currency or a State of the United States and therefore subject to domestic regulation and supervision in the United States. Participation in the RTP network is limited to U.S. licensed banks and the U.S. licensed branches of foreign banks and, therefore, all participants are U.S. regulated and supervised institutions. TCH owner banks do not have access to RTP network code or transactional data flowing through the network (other their own transactional data if they are a network participant). RTP network participants only have access to their own transactional data.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR WARREN FROM ROBERT HUNTER

Q.1. In 2013, The Clearing House released a report that acknowledged "A monopoly, however, eliminates competition, and competition is necessary to drive customer value and innovation. With interoperability among payment systems, operators can compete vigorously to provide value for their participants and enjoy the value created by a ubiquitous network."[1] More recently, TCH has

visory authority encompasses all aspects of TCH's operations given the shared infrastructure of the company.

[1] The Clearing House, "U.S. Payment System: Recommendations for Safe Evolution and Future Improvements", December 3, 2013, *https://fedpaymentsimprovement.org/wp-content/uploads/2013/12/Response-The-Clearing-House-120313.pdf.*

pushed back against efforts to create a competitive real-time payments marketplace and has even suggested it could change its pricing model in a way that negatively affects smaller institutions as a result of the Federal Reserve's proposed FedNow.[2]

Why has TCH changed its view regarding the need for competition in the marketplace in the past 6 years?

A.1. TCH has not changed its view regarding the need for competition in the marketplace and, indeed, there is robust competition in the marketplace for faster payments, including competition from Visa, MasterCard, numerous FinTech companies, same-day ACH, and others. The Federal Reserve's Faster Payments Task Force alone received 16 different private sector proposals that were responsive to its call to the private sector to address the need for faster payments in the United States. While TCH welcomes competition from the private sector, competition from Government, and specifically the Federal Reserve, which also regulates and supervises TCH, is not competition that is based on a level playing field.

When the Federal Reserve competes with the private sector, it should do so in a manner that minimizes the competitive advantages that a Government system would have, both inherently and as a direct byproduct of the Fed's role as a supervisor, the supplier of liquidity to the financial system and the Central Bank. For TCH, this is not the usual competitive question of impact on profitability because TCH does not seek to operate at a profit. Rather, it is a question of TCH's ability to provide the most effective and efficient real-time payment system to consumers and businesses, to the ultimate benefit of this country's overall economy.

As noted in my prepared testimony, to help TCH achieve this objective, we believe there are several actions the Fed should take now, before launching its FedNow service, that would help to create competitive equality between the private sector and the Government.

First, payments on FedNow will settle directly through financial institutions' master accounts at the Fed, which means the balances held in the accounts used for FedNow payments will count towards reserve requirements and bear interest. The Fed should accord the same treatment to financial institution positions in the RTP account that is held at the Federal Reserve Bank of New York, which facilitates RTP settlement.

Second, it appears that the Fed will provide unlimited access to liquidity (no real-time monitoring) even on nights and weekends when the discount window is closed. In contrast, consistent with the Federal Reserve policy for using its joint account, the RTP network does not extend credit to and does not permit credit exposures to arise among its participants. Instead, like other private sector systems, the RTP network is dependent on Fedwire or NSS to manage liquidity. The Federal Reserve should therefore move forward with making them available 24x7 to provide comparable liquidity and enable private sector competition.

Finally, we note that the report cited predates the development of systems architecture for The Clearing House's RTP® network

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[2] American Banker, "Community Bankers Alarmed After Big Banks Backtrack on Faster-Payments Pricing", Kevin Wack, April 10, 2019, *https://www.americanbanker.com/news/community-bankers-alarmed-after-bie-banks-backtrack-on-faster-payments-pricing.*

and contains certain assumptions about the potential for interoperability between real-time gross settlement systems that, unfortunately, are not consistent with the reality of how those systems work either here or abroad. Based on our knowledge of how such systems work today, we are not optimistic about the potential for interoperability and understand, based on our reading of the Federal Reserve's FedNow proposal, that the Federal Reserve is not optimistic about the potential for such interoperability either.

Q.2. To justify a potential change in the pricing model of the RTP Network in response to FedNow, you have cited the Federal Reserve's use of volume discounts. However, the Fed has not yet determined its pricing model. Given your acknowledgement during the hearing that TCH does not seek to make a profit, if the Fed does not implement volume discounts, will TCH commit to maintaining its flat fee pricing structure?

A.2. TCH built the RTP system to benefit financial institutions of all sizes and has already publicly committed that TCH will operate the RTP® network "as a utility for the benefit of the industry" and that RTP fees will "be flat for all participants regardless of size and shall not include volume discounts or minimum volume requirements." TCH would consider a change to this approach only if another provider's different approach to pricing were to threaten the viability of the RTP network and require TCH to react competitively to maintain the integrity and availability of the RTP network to all financial institutions. This is exactly what happened in the ACH market in the mid-1990s when the Federal Reserve introduced volume discounts into its ACH pricing. At the time, TCH was committed to a level pricing structure for financial institutions regardless of size. Ultimately, however, the Federal Reserve's introduction of volume discounts into the ACH has led to small banks paying 4–5 times the per transaction fees of large financial institutions and there is significant concern that the Federal Reserve may follow similar pricing practices with regard to the pricing of its FedNow product. Specifically, TCH notes that while TCH has made its commitment to level pricing abundantly clear, the Federal Reserve has repeatedly refused to make that same commitment.

RESPONSES TO WRITTEN QUESTIONS OF CHAIRMAN CRAPO FROM ROBERT A. STEEN

Q.1. The question I want to address is the one of digital currencies. Are we moving, technologically to a whole different world that central banks and financial institutions need to be more focused on? How transformative will this be?

A.1. The current limited regulation and oversight of the virtual currency marketplace exposes consumers and investors to significant risks. Appropriate regulation is vital for ensuring public trust and consumer protection and mitigating prudential risks for virtual currency stakeholders.

A reasonable legal and regulatory regime is necessary to manage the consumer and prudential risks related to the purchase, holding, and use of virtual currency.

Virtual currency companies and activities should adhere to comparable levels of regulation applicable to traditional, functionally similar payments products and services offered by closely regulated banks which includes requirements covering:

- capital adequacy and reserves;
- activity restrictions;
- information security;
- business resiliency;
- ownership and control;
- anti–money laundering and anti-terrorist financing;
- reporting and maintenance of books and records;
- consumer protection;
- ongoing examination.

An appropriate regulatory framework should not contain overly broad definitions for "virtual currency" and "virtual currency business activities" but should be broad enough to ensure that the activities that create the greatest consumer and prudential risk are subject to regulation.

A legal and regulatory regime should not apply to regulated banks which are already subject to extensive regulation. And finally, without well defined and legitimate use cases for crypto currency, there is an equally questionable purpose or business case for developing such a regulatory regime.

None of this, however, should preclude innovation around digitizing the U.S. dollar as part of the real-time settlement process within the FedNow design.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR BROWN FROM ROBERT A. STEEN

Q.1. For a community bank, what are the costs associated with joining a private-sector payments system like TCH compared to a Fed-operated network?

A.1. While the FedNow service has not yet disclosed their pricing schedule, it is the start-up costs, particularly from my core processor, that are of greatest concern to my bank. My core processor generally charges tens of thousands of dollars to connect to a provider such as TCH. My bank already has a connection to the Fed, so those costs will be substantially mitigated. As a settlement provider for the ACH, the Fed employs volume-based pricing, but my bank, despite being small and paying fees adjusted for low volume, still find it is very reasonable. Having two providers will also provide competition to ensure fair and reasonable pricing.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR WARREN FROM ROBERT A. STEEN

Q.1. Your written testimony acknowledges the important role of community banks in the small business lending market.

Describe how the lack of a ubiquitous real-time payments structure has impacted the ability of community banks to serve small businesses.

A.1. Small businesses and independent contractors rely on short term cashflow to stay competitive. The quicker the funds are in the account, the less the need for temporary credit. A ubiquitous real-time payments settlement rail will compliment and address this need.

Q.2. Do you believe that community banks have lost small business customers as they are forced to resort to high-cost alternative lenders to meet their cash needs in a timely fashion?

A.2. The lack of a ubiquitous real-time settlement has not materially impacted our bank's small business lending. However, the addition of ubiquitous real-time settlement would assure that funds are posted upon payment and would improve a small businesses' cashflow.

Q.3. Community banks are also unique in their ability to serve and maintain relationships with individual consumers.

Describe how the lack of a ubiquitous real-time payments structure has impacted the ability of community banks to serve the needs of individual customers.

A.3. The payment system, especially the ACH, has served our customers well. It provides a low-cost settlement to ensure that the customer has access to the funds early on payday or even hours before payday. However, the additional of a ubiquitous real-time settlement rail could disrupt the way we think about payroll, especially for contractor pay and task-based services, ensuring the employee or contractor has immediate access to funds.

Q.4. Has the emergence of nonbank lenders that individuals can use to instantly transfer funds impacted the customer base of community banks?

A.4. Nonbank lenders, while not having the ability to instantly transfer funds to consumer, can trap our customer in a cycle of debt, with extremely high interest rates and unreasonable payments terms.

Q.5. Do you believe that community banks have lost individual customers as they are forced to resort to high-cost alternative lenders to meet their cash needs in a timely fashion?

A.5. Bridge Community Bank does not believe we have lost consumer customers due to the lack of a ubiquitous real-time settlement, However, the addition of a ubiquitous real-time settlement rail would assure that funds are posted immediately and would provide immediate funds to consumers that may in many cases avoid the need for short term borrowings.

Q.6. Supporters of the payments system operated by TCH have pointed to the use of third-party service providers (TSPs) as a mechanism for that system to achieve ubiquity. Yet many others disagree, and have argued that the smaller and medium-sized banks, particularly those situated in less populated areas, do not have established relationships with reliable TSPs.

Do community banks and smaller financial institutions generally have relationships with the service providers they would need to implement a private sector real-time payments system?

A.6. Virtually all community banks have relationships with third-party core processors, who either write the in-house data systems for community banks or house the bank's customer data. This relationship is essential to all community banks and the core processor relationship serves as one of the most important vendor relationships for a community bank. It is, however, a complex and costly relationship, requiring community bank ongoing oversight. Many times, it is time consuming and extraordinarily costly for our core processor to link to services such as Zelle and RTP. All of those costs are passed down to our bank. Our core processor is already interfaced to our Federal Reserve connection, which gives us direct access and a material head start.

Q.7. Do community banks have concerns regarding the cybersecurity risks associated with third-party service providers?

A.7. Protecting our customers' data is our primary concern and we regard our core processor as an ally in this. Like any bank, we remain vigilant that any technology partner, especially the core processor protects our customers data and we are steadfast in overseeing this relationship protects our bank and its customers. We fully understand that our bank could not withstand a significant breach of our customers' personal information such as the recent 107 million customer identity loss from one of the large banks.

Q.8. Currently the Federal Reserve does not provide a service that would allow banks to move liquidity to support the real-time settlements of faster payments.

How would the expansion of the hours for the Fedwire Funds Service and National Settlement up to 24x7x365 support faster payments?

A.8. The Federal Reserve should begin the process of improving liquidity tools for the existing services and would then be better prepared for those tools being available for FedNow. Beyond that, we see the expansion of hours for Fedwire and the National Settlement Service as an extremely important step toward payments efficiency. Not only will it benefit real-time settlement systems such as FedNow and RTP, but it can improve the service of existing services such as ACH and wire transfer. However, community banks will have to modify our procedures and forge partnership to ensure their liquidity during off hours.

Q.9. What benefits would this additional service provide to consumers and small businesses?

A.9. These changes, while significant, will provide an overall benefit to all our customers and will accelerate the delivery of funds to our customers. End users do not need immediately available funds until they do. Those instances, along with use cases we have yet to see, make this worthwhile.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR BROWN FROM SHEILA C. BAIR

Q.1. I have been concerned about private entities like Facebook introducing digital currencies as an alternative to the U.S. dollar or other fiat currencies. In your testimony, you expressed your support for the Federal Reserve to explore the use of digital currency, including cryptocurrency based on distributed ledger technology (DLT). What disruptions to the financial system could occur if we allow private digital currencies to compete with the U.S. dollar? Why is the Fed in the best position to use DLT for payments?

A.1. You are right to be concerned about the potential for financial disruptions from a privately sponsored digital currency such as Libra. These risks include the possibility of bank runs, credit disruptions, and consumer losses from foreign currency risk or financial mismanagement of the Libra reserve. What we've learned from Bitcoin is that digital currencies not tethered to fiat currency will be too volatile to function as a medium of exchange. Thus, privately offered digital currencies will need to be tied to fiat currencies to maintain stable value. Libra's sponsors propose to do that by tying their currency to a basket of stable fiat currencies. But there is no apparent regulatory authority to make sure that the managers of the Libra reserve will responsibly invest the money it receives from its customers in exchange for Libra.

Libra's sponsors have promised to invest it only in high quality Government debt and bank deposits but since they will make their profits from the returns on those funds, their incentives will be to look for yield. And if they invest in risky assets which suffer losses, this could prompt a run on Libra similar to the runs on money funds we experienced during the financial crisis. Even if the reserves are responsibly invested, Libra purchasers will still be subject to foreign currency risk when they exchange their Libra back into their own fiat currency. This may not be well understood by public.

Payments systems are, by nature, natural monopolies. The more users who join the same payments network, the more efficient and convenient it becomes. Thus, if a privately sponsored digital currency such as Libra did gain critical mass, it could prompt a quick and destabilizing exodus of money out of traditional banking systems. People could quickly withdraw money from their banking accounts to purchase Libra if they saw it as a cheaper, faster way of making payments than that offered by their banks. This could destabilize banks, but could also lead to a credit contraction as it would shrink the amount of deposits available for lending. If most of Libra's reserves are invested in Government debt, this could result in an inefficient reallocation of capital from deposits, which fund private lending, to Government balance sheets. Libra's sponsors say that at least some of the Libra Reserve would be redeposited in banks of their choosing. This money would remain in the banking system but would likely be reallocated to large institutions selected by Libra's sponsors, increasing concentration in the banking sector and likely damaging smaller community banks. Moreover, unlike the bank deposit accounts used by retail Libra users—which would be protected up to FDIC-insured deposit limits—Libra reserve deposits would likely far exceed those limits, exposing the Libra reserve to credit losses if any of the big banks holding those reserves fail.

These kinds of problems could be preempted and solved through a central bank digital currency (CBDC). The Fed or other central bank could issue a limited amount of CBDC for the purpose of making payments. This could be done through accounts kept at traditional banks. CBDC would capture the efficiencies of modern technology to provide for efficient, secure, and low-cost real-time payments, while maintaining control over the amount in circulation. Short of CBDC, there are other ways the Fed could use distributed ledger technology (DLT) to achieve greater efficiencies in payments and preempt private efforts to replace fiat systems. A first step might be to construct a distributed ledger that could be accessed only by regulated, insured depository institutions. Such a ledger would enable each institution, regardless of size or resources, the ability to directly transfer funds to one another on the ledger in "real time," without the need for an intermediary. I hope that the Fed will explore this use of DLT in constructing FedNow.

Q.2. Wall Street has been very successful recently in beating back many of the reforms we put in place to prevent another big bank bailout, including, for example, the Volcker Rule and the swap-margin rule. Why were these rules put in place and how do the recent changes exacerbate the risks to our financial system?

A.2. The Volcker Rule was put in place to prevent banking organizations benefiting from low-cost FDIC-insured bank deposits, from engaging in reckless speculation of the kind we saw during the financial crisis. Unfortunately, what started as a good faith effort to simplify the regulations implementing the Volcker Rule turned into a "ploy to weaken core elements of the reform." as Paul Volcker wrote to Jerome Powell in an Aug. 20 letter. Making the weakening of the Volcker Rule more problematic is the previous effective repeal of Dodd–Frank (DFA) protections against the use of FDIC-insured banks to support deal-making in high risk derivatives. Originally, DFA prohibited insured banks from holding uncleared swap positions. (Uncleared swaps can be among the riskiest. When a clearinghouse refuses to be the central counterparty to a derivative instrument, it is because it does not understand the risk of the instrument and how to manage it.) In 2014, in response to industry lobbying, Congress gutted this swaps "push-out" rule. The 2014 change allowed broker-dealer affiliates of big banking organizations to transfer the risks of their uncleared derivative transactions to FDIC-insured subsidiaries. This increased risk to the FDIC deposit insurance fund, but fattened banks' derivatives profits. (Derivatives customers agree to more favorable terms when FDIC-insured banks act as their counterparties because the insured banks are safer than noninsured broker-dealers which generally have lower credit ratings, weaker capital requirements and less stable funding.) These increased risks to the FDIC are now exacerbated by the changes to the Volcker Rule and swap-margin rule. The Volcker Rule still had an overarching prohibition against the use of swaps and other instruments for speculative proprietary trading. And the original swap-margin rule at least required affiliates to post initial "margin" or collateral against the swap exposure when it was transferred to the insured bank. Those safeguards no longer apply.

This is a good example of how a series of stand-alone changes represented to be "minor tweaks" to the existing framework work in combination to substantially weaken postcrisis reforms.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR WARREN FROM SHEILA C. BAIR

Q.1. In your written testimony and previous writings, you have described the impact of the Federal Reserve developing a real-time payments (RTP) system on the resiliency of the financial sector. [1] The largest financial institutions, via The Clearing House (TCH), currently have an effective monopoly over the real-time payments in the United States via the for-profit settlement service RTP network.

Does this current market structure create additional systemic risk in the financial sector?

Do you believe that the protections against credit risk included in the design of the RTP network are sufficient to eliminate the systemic risk associated with a single point of failure in the RTP market?

A.1. The credit risk protections are untested in a crisis. We don't know how well they will work. In addition, they are designed to protect the other banks funding the joint account from exposure to the default of a participating bank, not the defaulting bank's customers who would lose access to RTP. Most importantly, they do not provide protection from operational disruptions which could be caused, for instance, by management error or a security breach. FedNow would provide a second system to ensure continuity of real-time payments if RTP was compromised or failed for whatever reason. Moreover, given the Fed's broader role of providing liquidity support in times of financial stress, it would be in a better position to support payments in times of crisis.

Q.2. If not, why not, and how would the creation of FedNow address these systemic risk concerns?

A.2. The Fed has a strong proven track record in managing through crises and by its nature, it cannot fail. Its FedNow system would not need to depend on the financial backing of large banks to provide liquidity. Though the Fed has not decided on the basic architecture, presumably real-time interbank payments will occur with the Fed acting as the central intermediary or possibly through a distributed ledger where payments can be transmitted directly from the sender's bank account to the recipient's bank account. (The Fed has said it is researching DLT as one approach.) In either case, there is no need for intermediation by TCH or the large banks that own its system. If interoperability is achieved, then this transition to FedNow in the case of an RTP disruption should be seamless. Absent interoperability, presumably all major banks would belong to both systems. Critics of FedNow have argued that the need to participate in two real-time payments systems imposes unnecessary costs on the payments system. I would argue that having this redundancy for something as essential payments is well worth any incremental cost and is common in other payments system such as ACH.

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[1] Yahoo Finance, "Why the Fed Is Right To Step in and Finally Make Real-Time Payments Happen", Sheila Bair, September 4, 2019, *https://finance.yahoo.com/news/fednow-real-time-payments-sheila-bair-175320549.html.*

Q.3. In your written testimony, you also stated that a potential future failure of the largest banks would result in a "conundrum similar to the one [taxpayers] faced in 2008: bail the banks out or expose households and businesses to disruptions in essential payment services."

Does the current market structure create additional moral hazard with respect to the incentives for policymakers to enact another bailout in the event of a failure of one of the largest institutions?

A.3. Yes. The economy cannot function without a well-functioning payments system. If we were solely reliant on TCH's RTP system and it failed because of the failure of one or more of its major members, the Fed's operational flexibility would be limited. It could well find itself forced into a bailout to keep the banks and RTP functioning. With FedNow, the Fed would have independent operational capability to maintain continuity of payments outside the RTP system. Denying the Fed an operational role in real-time payments—as TCH has advocated—would leave it on the sidelines and then force it to prop up RTP if there was a problem. Contrast this to the kind operational capabilities the Fed had during 9/11 when it was able to seamlessly step in and provide broad support for the market.

Q.4. If so, please describe how FedNow would help address those concerns.

A.4. As mentioned above, FedNow would be a parallel system that optimally would be interoperable with RTP though during the hearing, TCH's witness was inconsistent on the question of whether TCH would discuss with the Fed steps necessary to achieve interoperability. Absent interoperability, presumably all major banks would be members of both systems or have the ability to fall back on it if RTP failed.

Q.5. How would a real-time payments network dominated exclusively by the private sector impact the ability of the Federal Reserve to stabilize the financial system in the event of a future crisis?

A.5. See above.

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

REVISED STATEMENT OF GEORGE SELGIN

SENIOR FELLOW AND DIRECTOR, CENTER FOR MONETARY AND FINANCIAL ALTERNATIVES, CATO INSTITUTE

SEPTEMBER 25, 2019

Introduction

Chairman Crapo, Ranking Member Brown, and distinguished Members of the Committee on Banking, Housing, and Urban Affairs, my name is George Selgin, and I am the Director of the Cato Institute's Center for Monetary and Financial Alternatives. I am also an adjunct professor of economics at George Mason University, and Professor Emeritus of Economics at the University of Georgia.

I'm grateful to you for allowing me to take part in this hearing on "Facilitating Faster Payments in the U.S." The slow speed of many payments in this country is a cause of serious inconvenience and substantial losses to American businesses and consumers, and one that places an especially great burden on people living paycheck-to-paycheck, who can least afford to wait, sometimes for days, for checks or employer direct deposits to clear.[1] For that reason it is essential that Congress do everything in its power to facilitate the speeding up of payments in this country.

To assist Congress in that endeavor, I wish to draw your Committee's attention to some dangers posed by the Federal Reserve decision to proceed with FedNow—a real-time retail payments service that will compete directly with private-sector retail payments services. Specifically, I wish to discuss four ways in which the Fed's plan might hinder rather than facilitate the achievement of an equitable, efficient, and safe U.S. fast payments system, and to suggest steps Congress should take to guard against this outcome.

The Federal Reserve as a Payment Service Competitor

As a rule, competition is an effective—if not the most effective—means for encouraging providers of services to price those services equitably, to produce them efficiently, and to improve their quality over time. However, these outcomes depend on the presence of a level playing field on which all providers compete—that is, they depend on the various providers having roughly equal legal privileges and obligations. In the absence of a level playing field, the presence of multiple providers alone does not guarantee good outcomes. Instead, special care must be taken to guard against bad ones.

The Federal Reserve banks enjoy many legal advantages over private suppliers of payment services. They command a monopoly of bank reserves that serve as means of final payment; they are empowered to regulate commercial banks and some other private-sector payment service providers; and they are exempt from antitrust laws. Finally, although the 1980 Monetary Control Act requires that the Fed charge prices for its services that recover those services' capital and operating expenses, it only needs to do so over a "long run" of unspecified length, and then only according to accounting methods of its own choosing that are not subject to external review.

These and other Fed privileges mean that, when it enters into direct competition with private-sector payment service providers, it does so on a playing field that it can easily slant in its favor. It is owing to this that the Fed itself has established strict criteria it must meet before offering any new payment service, including the requirement that the service in question "be one that other providers alone cannot be expected to provide with reasonable effectiveness, scope, and equity."[2]

In responding to the Fed's request for comment regarding "Potential Federal Reserve Actions To Support Interbank Settlement of Faster Payments", I argued against the Fed's then-proposed retail RTGS (Real Time Gross Settlement) payment service partly on the grounds that it did not meet the Fed's own criteria for pro-

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[1] For some figures see Aaron Klein, "How the Fed Can Help Families Living Paycheck to Paycheck", Brookings Series on Financial Markets and Regulations, November 22, 2017, and idem., "The Fastest Way To Address Income Inequality? Implement a Real-Time Payment System", Brookings Series on Financial Markets and Regulations, January 2, 2019. Available at *https://www.brookings.edu/research/how-the-fed-can-help-families-living-paycheck-to-paycheck/* and *https://www.brookings.edu/research/the-fastest-way-to-address-income-inequality-implement-a-real-time-payment-system/*, respectively.

[2] See Board of Governors of the Federal Reserve System, "Policies: The Federal Reserve in the Payments System", available at *https://www.federalreserve.gov/paymentsystems/pfs_frpaysys.htm.*

viding new payments services.[3] I also argued that the new service would delay progress toward a ubiquitous U.S. fast payments system. I continue to hold these views.

I also fear that, instead of preventing private-sector payment service providers from engaging in anticompetitive behavior, the Fed will itself engage in such behavior. In my testimony today, I wish to draw attention to four particular anticompetitive dangers that the Fed's entry into the fast payments business poses, and to recommend steps Congress should take to guard against each.

Postponed Fed Settlement System Reform

The first danger is that the Fed will treat FedNow as a substitute for a 24x7x365 expansion of the operating hours of Fedwire, its wholesale RTGS service, and NSS (the National Settlement Service), a separate multilateral settlement service that is also owned and operated by the Federal Reserve banks.[4] The availability of 24x7x365 Fed settlements is essential to achieving faster (though not necessarily real-time) and safer payments on other payment services. But instead of hastening to offer that service, the Fed may delay doing so to limit private payment services' ability to compete with it.

The danger here stems from the Fed's monopoly of final means of payment, including bank reserves. Because of that monopoly, most private noncash payments, including most check, card, and ACH (Automated Clearing House) payments, can only be completed with the help of either Fedwire or the NSS or both. Only once settlement takes place can recipient banks credit funds to a payee's account without assuming some credit risk. Because Fedwire and the NSS operate only on weekdays, excluding holidays, and then with limited hours, retail payment services that rely on them are correspondingly limited in their ability to complete payments both quickly and safely at all times.[5]

Although it would also enhance the efficiency of private real-time payments services, the main benefit of 24x7x365 Fed settlement services would consist of a substantial reduction in delays on "legacy" payment networks.[6] For example, today's Fedwire and NSS operating hours currently stand in the way of National Automated Clearing House Association's (NACHA) long-standing effort to enhance ACH's same day payment services by providing for a third ACH "processing window." Although NACHA had hoped to make this third window available by September 2020, and the change required only a minor extension of Fedwire and NSS operating hours, the Fed failed to prepare for the change on time, forcing NACHA to postpone its planned reform until March 2021.[7]

When the Fed requested public comment on whether it should establish its own fast payments network, it also asked whether it should either arrange to have Fedwire and the NSS operate 24x7x365 or establish a new "Liquidity Management Tool" for the purpose of allowing 24x7x365 transfers among commercial banks' Federal Reserve accounts. Almost every response to this question favored having the Fed pursue one of these proposed reforms (most respondents did not care which), making the proposal much less controversial than the Fed's plan to establish its own retail RTGS service. Yet despite this, and the relative easiness and great potential benefits of the asked-for reform, the Fed ultimately chose to do no more than

[3] Available at *https://www.cato.org/publications/public-comments/re-potential-federal-reserve-actions-support-interbank-settlement.*

[4] The NSS serves "depository institutions with Federal Reserve master accounts that settle for participants in clearinghouses, financial exchanges and other clearing and settlement arrangements." For further details see FRBServices.org, "National Settlement Service", available at *https://www.frbservices.org/financial-services/national-settlement-service/index.html.*

[5] The Fed has long recognized this potential benefit of making its settlement services available 24x7x365. See Board of Governors of the Federal Reserve System, "Strategies for Improving the U.S. Payment System", January 26, 2015, p. 50. Available at *https://www.betterthancash.org/tools-research/resources/federal-reserve-strategies-for-improving-the-us-payment-system.*

[6] Because RTP settlements occur on the books of a special Fed account jointly owned by RTP participants, it can operate 24x7x365. However, its participants depend on Fedwire or the NSS to occasionally replenish their individual RTP account balances. The settlement services' limited operating hours raise participants' costs of using RTP by obliging them to maintain larger non–interest earning RTP account balances than they otherwise might, especially going into weekends. Concerning the non–interest-bearing status of RTP account balances, see below.

[7] Jim Daly, "Fed Delay Causes NACHA To Postpone a Third Processing Window for ACH Transactions for Six Months". *Digital Transactions*, September 30, 2019. Available at *https://www.digitaltransactions.net/fed-delay-causes-nacha-to-postpone-a-third-processing-window-for-ach-transactions-for-six-months/.*

continue to "explore" the possibility of offering 24x7x365 settlement services, and to perhaps seek comment upon the proposal yet again! [8]

Why is the Fed dragging its feet on an almost universally favored reform that could alone suffice to eliminate most of the more notorious payment delays in this country? [9] The Fed's actions seem at odds with its overarching public mission. But they are what one would expect from a firm endeavoring to compete successfully with rival payment service providers. For example, when NACHA was first endeavoring to make same-day ACH payments possible, its efforts were opposed by several large banks. It was widely suspected, according to a contemporary report, that this opposition stemmed from those banks' intent "to build their own proprietary electronic payment systems, which could give them a leg up on smaller banks." [10] The Fed's hesitation to make 24x7x365 Fed settlements available to private payment service providers may likewise reflect its own desire to give FedNow "a leg up" on other payment networks. [11]

Whatever the Fed's motives, Congress should not allow it to delay a badly needed enhancement of its settlement services any longer. Instead, it should give the Fed 2 years within which to either place its Fedwire and NSS services on a 24x7x365 operating basis, or establish an alternative 24x7x365 Liquidity Management Tool. If Congress does not do this, I fear that Congress will overlook the most important of all steps it might take to dramatically and rapidly enhance the speed of U.S. retail payments.

Volume-Based Pricing Favoring Large Banks

A second danger the Fed's entry into the fast payments business poses is that, by resorting to volume-based pricing, the Fed will ultimately put small banks that wish to offer fast payment services to their customers at a disadvantage.

Because many are counting on the Fed to guard against rather than introduce volume-based fast payment fees, some background is required to understand why that expectation exists, and why just the opposite might happen.

The only potentially ubiquitous real-time payments service that exists at present, the RTP system established by TCH (The Clearing House) in 2017, presently operates on a contractually binding flat-rate basis, with no minimum volume requirements. [12] But TCH's flat-fee commitment isn't absolute: instead, it allows RTP to alter its pricing policy in the event that the Fed enters into competition with it. Noting this, Fed officials and others have argued that RTP cannot be trusted to make certain that small banks continue to receive equitable treatment, instead of finding themselves placed at a disadvantage relative to their large competitors. That TCH is itself owned by 25 of the Nation's largest banks makes the risk to smaller banks seem all the more obvious. Consequently, the Fed and others argue, having FedNow directly compete with RTP is the surest way to keep RTP from reneging on its flat-fee commitment.

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[8] 84 FR 39301. Available at *https://www.govinfo.gov/content/pkg/FR-2019-08-09/pdf/2019-17027.pdf*. In early 2015 the Fed had said it would begin exploring "the technology, infrastructure and operational and resource changes required to support weekend and/or 24x7 operating hours" of its settlement services during or soon after 2016. See Board of Governors, "Strategies for Improving", pp. 21 and 51.

[9] Because the most costly payment delays at present are those that keep workers waiting not hours but days for payments to clear, "The Fastest Way To Address Income Inequality" stemming from such delays is, with all due respect to Aaron Klein (op. cit.), not to have the Fed implement FedNow, which will not be ready for several years, but to have it offer 24x7x365 settlement services, which should take much less time.

[10] Kevin Wack, "How Big Banks Killed a Plan To Speed Up Money Transfers". *American Banker*, November 13, 2013. Available at *https://www.americanbanker.com/news/how-big-banks-killed-a-plan-to-speed-up-money-transfers*. Although Wack here refers to TCH as NACHA's "most visible foe," it only appears that some of TCH's owner banks opposed NACHA's plan. In a comment letter TCH itself submitted, in its capacity as an ACH operator, to NACHA in February 2015, it expressed its overall approval of NACHA's proposal. TCH's comment letter is available at *https://www.theclearinghouse.org/-/media/files/association-documents-2/20150206-comment-letter-to-nacha-supporting-same-day-settlement.pdf*.

[11] NACHA itself seems to have anticipated this outcome. In its own comment letter concerning the Fed's various proposals, it complained that the Fed already appeared to be retreating from what once seemed to be a commitment to further expand Fedwire and NSS operating hours, while expressing its fear that it was doing so in order to favor the establishment of its own real-time retail payments systems, over measures that could further expedite payments on legacy systems. See Jim Daly, "NACHA Wants the Fed To Take a Broader View of Faster Payments", *Digital Transactions*, December 5, 2018. Available at *https://www.digitaltransactions.net/nacha-wants-the-fed-to-take-a-broader-view-of-faster-payments/*.

[12] For RTP's pricing policies see *https://www.theclearinghouse.org/payment-systems/rtp/-/media/00a1f095c9a049fea6c3e2e5fbc2c6ad.ashx*.

But closer consideration of TCH's general pricing practices, along with some history, suggest that the Fed's entry is more likely to have just the opposite consequence. Regarding TCH's practices, in seeking a statement from the Justice Department's Antitrust Division "of its present intention not to seek any enforcement action against" the RTP system it was then developing, TCH explained that it:

> operates on a "utility" model, charging fees only to cover the costs incurred in operating its CHIPS, EPN, and check imaging systems and to support future innovation, and does not pay dividends to its owner banks.[13] Accordingly . . . TCH owner banks . . . will benefit by participating in the RTP system and enhancing their abilities to compete more effectively among themselves and with non-TCH owner banks and nonbank payment service providers.[14]

The veracity of TCH's claims is attested to both by the known pricing practices of its established payment systems and by the Justice Department's conclusion that RTP did not in fact pose "significant anticompetitive threats."[15]

FedNow, in contrast, does pose such a threat, as is clear from what happened in the case of ACH payments. The Fed competes with TCH, and in the past competed with other private-sector providers, in providing ACH payment services. TCH initially charged flat ACH fees. But during the 1990s, the Fed, in an effort to compete more aggressively in an increasingly national ACH market, resorted to volume-based ACH fees.[16] The Fed's move compelled TCH to follow suit to avoid losing the business of its larger ACH customers. Yet TCH's ACH prices are still more favorable to small banks than those charged by the Fed, which charges many smaller banks five times the per-transaction fee it charges its largest customers.[17]

It was to protect itself from such potential Fed competition, and not (as Fed officials have suggested) to be able to ultimately resort to discriminatory pricing, that TCH made its flat-rate commitment contingent on the Fed's not entering into competition with it. Were TCH not to do this, it would risk having FedNow bid away its large participants.

To avoid having volume-based pricing undermine the goal of equitable real-time payments, Congress must do more than merely trust the Fed not to engage in such pricing. At very least, it should insist that the Federal Reserve Board follow TCH's example by making a public commitment to refrain from offering volume-based discounts on FedNow or, at very least, by publicizing a specific, anticipated FedNow pricing policy, such as it presumably employed in assessing the new service's feasibility and desirability. As then Richmond Fed economist John Weinberg observed some years ago, "When the Fed is one of several competitors, it can contribute to

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[13] CHIPS (for Clearing House Interbank Payment System) is TCH's large-value interbank payment service, while EPN (for Electronic Payments Network) is its ACH (Automated Clearing House) operations service. [This writer's note.]

[14] Richart Taffet, "The Clearing House Payment Company LLC's Request for Business Review Letter", October 11, 2016. Available at *https://www.justice.gov/atr/page/file/998216/download.*

[15] Andrew C. Finch, "The Clearing House Payments Company LLC Business Review Request", September 21, 2017. Available at *https://www.justice.gov/atr/page/file/998201/download.*

[16] Some years earlier, when the Fed first sought comment on its plans to establish nationwide EFT (Electric Funds Transfer) services, the Justice Department's Antitrust Division commented in favor of the Fed's adoption of a nondiscriminatory pricing system, noting that a discriminatory pricing system could prove to be "as substantial a bar to competition as exclusionary rules." Anatoli Kuprianov, "The Monetary Control Act and the Role of the Federal Reserve in the Interbank Clearing Market", *Federal Reserve Bank of Richmond Economic Review*, July/August 1985, p. 31. Available at *https://www.richmondfed.org/-/media/richmondfedorg/publications/research/economic_review/1985/pdf/er710403.pdf.*

As Mark Weinberg has observed, whereas uniform average-cost pricing generally "maximizes net social benefits subject to the constraint that total revenues from the sale of the product just equal total costs," volume-based pricing, a form of price discrimination, does not. Consequently the Fed's resort to the latter "raises some important questions," including whether "the Reserve Banks' 'business interests' [are] in conflict with their public policy responsibilities." "An efficiency perspective," he continues, "dictates that a loss of market share by the Federal Reserve is neither good nor bad per se. What matters is the overall cost efficiency of the market. If the Federal Reserve is replaced by providers with lower costs, then such a change should be accommodated. The goal of pricing policy, however, should be that only efficiency-enhancing losses are experienced." John A. Weinberg, "Selling Federal Reserve Payment Services: One Price Fits All?" *Federal Reserve Bank of Richmond Economic Quarterly*, Fall 1994, pp. 3 and 8. Available at *https://www.richmondfed.org/-/media/richmondfedorg/publications/research/economic_quarterly/1994/fall/pdf/weinberg.pdf.*

[17] Thomas Wade, "How the Federal Reserve's Automated Clearing House Informs the Fed's Proposed Real-Time Payments Entry", *American Action Forum*, July 11, 2019. Available at *https://www.americanactionforum.org/insight/the-federal-reserves-automated-clearing-house/.*

the efficiency of the market by adopting a clear pricing policy to which other sellers can react."[18]

Prejudicial Treatment of Balances in Jointly Held Fed Accounts

The third danger stems from the Fed's ability to refuse to classify bank balances held in jointly owned Fed accounts as reserves, and to do so even when the accounts in question are "intended to facilitate settlement between and among depository institutions participating in private-sector payment systems."[19]

Fed balances classified as "reserves" earn interest, while those not so classified do not. Consequently, by refusing to classify the jointly held Fed balances held by banks participating in a private payments network as reserves, the Fed adds to the cost of participating in that network, and hence to the relative attractiveness of other networks, including those it itself operates, that aren't subject to the same "reserve tax." The Fed's status as bank regulator can thus allow it to compete unfairly by "raising [its] rivals' costs."[20]

Although the Fed allows "only an institution eligible to have a Federal Reserve account under the applicable Federal statute and Federal Reserve rules, policies, and procedures" to be a joint account holder, it reserves the right to determine whether balances in joint accounts count as reserves on a balance-by-balance basis.[21] Today, the Fed administers three joint accounts serving to facilitate settlements among participants in TCH's CHIPs, RTP, and EPN networks.[22] So far as I'm aware, it has not yet chosen to treat balances in any of these accounts as reserves. Consequently those balances neither bear interest nor qualify as "High Quality Liquid Assets" that can satisfy Basel's LCR (Liquidity Coverage Ratio) requirements.

I can think of no economic reason why the Fed should not classify all Federal Reserve bank balances held in joint accounts used in settling payments as reserves, and to accord such balances the same privileges as other reserve balances. RTP account balances, for example, are no less liquid than banks' regular Fed account balances, and serve the same purpose of supplying their owners with means for settling payments. That banks choose to fund their RTP accounts rather than their individual Fed accounts, so as to allow them to make real-time payments instead of relying on slower ones, should not subject them to any avoidable penalties.

Moreover, by refusing to treat RTP balances as reserves the Fed may complicate its monetary policy operations unnecessarily by creating a new "autonomous" determinant of the total stock of bank reserves. As the Fed itself explains:

> if joint account balances are not treated as reserves, they are a factor affecting the supply of reserve balances, meaning, all else equal, movements in joint account balances have similarly sized but opposite effects on the supply of reserve balances, which the Federal Reserve will need to offset to provide the appropriate level of reserves in a scarce reserve regime.[23]

In short, the Fed's ability to refuse to classify balances held in joint accounts "intended to facilitate settlement" on private payments system with which it competes represents a clear conflict of interests. To resolve this conflict, and thereby assure that the Fed competes fairly with rival payment service providers, Congress should compel the Fed to classify all balances held in joint Federal Reserve bank accounts as reserves, provided only that the accounts in question are designed to facilitate settlements on private payments networks. Congress should also have the Government Accountability Office (GAO) occasionally review the Fed's handling of applica-

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[18] Weinberg, op. cit., p. 20.

[19] For the Fed's rules for establishing such joint accounts see 82 FR 41951, available at *https://www.govinfo.gov/content/pkg/FR-2017-09-05/pdf/2017-18705.pdf.*

[20] The seminal work here is Steven C. Salop and David T. Scheffman, "Raising Rival's Costs", *American Economic Review*, May 1983, pp. 267–271. Available at *https://www.jstor.org/stable/1816853?seq=1#metadata__info__tab__contents.*

[21] 82 FR 41956.

[22] Although most EPN ACH payments are settled using Fedwire, TCH relies on a joint Fed account to assist in the settlement of items sent by Fed ACH participants to EPN participants that choose to be identified by UPIC (Universal Payment Indication Code) numbers only, so as to avoid divulging confidential banking information.

[23] See Federal Reserve System, "Final Guidelines for Evaluating Joint Account Requests", at *https://www.govinfo.gov/content/pkg/FR-2017-09-05/pdf/2017-18705.pdf.* Although the Fed presently operates an abundant reserve regime, recent experience has illustrated, rather dramatically, that under certain conditions the Fed may still have to intervene to offset autonomous reserve losses. See Nick Timiraos and Daniel Kruger, "Fed Intervenes To Curb Soaring Short-Term Borrowing Costs", *Wall Street Journal*, September 17, 2019. Available at *https://www.wsj.com/articles/fed-to-conduct-first-overnight-repo-transactions-in-several-years-11568729757.*

tions for such joint accounts, to ensure that it continues to abide by its current guidelines for granting them.

Abuse of Monetary Control Act Loopholes

Finally, I wish to point to the risk that the Fed will take advantage of loopholes in the 1980 Monetary Control Act (MCA) to charge prices for its FedNow services that fail to cover their full costs, as that act requires. Thanks to its monopoly of paper currency, the Fed earns substantial "seigniorage" revenue it can use to cross-subsidize its other payment services to the extent that MCA loopholes allow it.

Although the MCA is supposed to rule out such cross-subsidies, there are at least two defects in its provisions that can prevent it from doing so. One concerns the Act's requirement that the Fed's service fees cover its costs "over the long run." Because it fails to define "the long run," the Act as written allows the Fed to interpret the phrase as it pleases. In contrast, private-sector payment service providers must generally be able to recover the cost of new services rapidly enough to achieve a positive present value for those services.

Fed officials claim that they generally endeavor to recover the Fed's expenditures for established services within a 10-year period, but that they expect FedNow's "first instance of long-run cost recovery to occur outside" that 10-year cost recovery period.[24] However, they do not say how far outside, and the Fed incurs no penalties for failing to recover its costs within any specific length of time.[25] It follows that the Fed's investment in FedNow needn't have a positive present value, so that it can set FedNow fees below what a private-sector provider of an equally costly service could afford.

A second MCA loophole leaves to the Fed itself the choice of an internal cost accounting system by which the Fed allocates its expenditures among its various activities, while failing to provide for periodic and systematic external reviews of that accounting system to assure its adequacy. In consequence the last external review of the Fed's cost accounting system took place in 1984! External assessments of the Fed's success in complying with the MCA's cost recovery provisions, such as that undertaken by the GAO in 2016,[26] are therefore only as accurate as the Fed's own internal audits—a highly unsatisfactory circumstance.

By closing these MCA loopholes, Congress can prevent the Fed from underpricing its payments services, including FedNow. To do so, it should insist that the Fed offer compelling proof that it will be able to recover the costs of FedNow rapidly enough to give that project a positive present value using an equitable and competitive fee structure. Congress should also follow the GAO's 2016 recommendation that it provide for periodic independent reviews of the Fed's cost-accounting practices.[27] Together these changes should go far in assuring that the Fed competes fairly with private payment service providers.

Conclusion

I conclude my testimony by observing that none of the steps I have recommended to Congress would prevent the Fed from doing all that it can possibly do to facilitate faster payments in the United States. My recommendations will only serve to make sure that in competing with private-sector payment service providers, the Fed plays by the rules, as it must if it is to contribute to rather than hinder the speeding-up of U.S. payments. A well-intentioned Fed should therefore have no objection to them, while an ill-intentioned one will make them indispensable.

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[24] 84 FR 39314.

[25] GAO, "Federal Reserve's Competition With Other Providers Benefits Customers, but Additional Reviews Could Increase Assurance of Cost Accuracy", GAO-16-614, August 2016. Available at *https://www.gao.gov/assets/680/679388.pdf.*

[26] Ibid.

[27] Ibid., p. 64: "Having [the Fed's] cost accounting practices periodically subject to independent testing would provide greater assurance that the Federal Reserve is complying with the Monetary Control Act."

STATEMENT OF THE AMERICAN BANKERS ASSOCIATION

Statement for the Record

On behalf of the

American Bankers Association

before the

Banking, Housing and Urban Affairs Committee

United States Senate

September 25, 2019

Chairman Crapo, Ranking Member Brown and Members of the Committee, the American Bankers Association (ABA) is pleased to submit this statement for the record on the important topic of Facilitating Faster Payments in the United States. The ABA is the voice of the nation's $18 trillion banking industry, which is composed of small, mid-size, regional and large banks that together employ more than 2 million people, safeguard $13 trillion in deposits and extend more than $10 trillion in loans.

We appreciate the interest of the committee in examining this important and timely issue. ABA has been a strong advocate for real-time payments in the U.S. We believe every bank in the country and their customers will benefit from a seamless and ubiquitous system. As the committee is aware, on August 5th, the Federal Reserve (Fed) announced its intention to create a faster payments network. The proposed FedNow Services will be a real time gross settlement service. The Fed's decision will help speed the nation's transition to real-time payments, but it will take time to build as it is not expected to be active until 2023 or 2024.

The FedNow network will compete with The Clearing House's Real Time Payments network (RTP), which is now live and can reach over 50% of the deposit accounts in the U.S. The Clearing House has offered RTP since 2017. If launched skillfully, the Fed's new rail could ultimately enhance the adoption of faster payments by seamlessly integrating with other offerings in the marketplace. However, if FedNow does not prioritize certain characteristics such as interoperability with well-established solutions, a flat pricing model without volume discounts, and a strong oversight plan for core service providers, or if it freezes decision-making during a protracted development and launch period, it could slow the adoption of faster payments and cause confusion and fragmentation.

To move the United States toward an efficient, secure, ubiquitous real-time payment environment without undue delay, ABA believes that market participants should focus on six key issues and capabilities.

Interoperability

The Federal Reserve is proposing to enter a market where another operator already has access to more than 50% of deposit accounts and will continue to grow market share while FedNow is in development over the next 4-5 years. Both systems will be run on a cost recovery basis as non-profit utilities with the goal of achieving ubiquity – connecting to every financial institution in the U.S. Volume is critical so the competing systems must be able to interoperate. The ability to originate a real time payment on one platform and have it be received on another platform is essential to deliver a positive customer experience. Without interoperability, banks would be forced to choose between offering a payment network or networks that cannot reach all people, or operate multiple networks which cannot accept payments from one another. The first choice would result in a fragmented system that would not serve consumers and the second choice would be inefficient and expensive to operate.

Despite a broad-based request from industry during last year's comment period, the Federal Reserve Notice made no commitment to achieving interoperability with the already existing in-market solution RTP Network on the first day of operation. Further, the Federal Reserve opined that it would be acceptable if "nationwide reach" was attained through multiple networks that were not interoperable.

Interoperability should be the highest priority for FedNow as the Federal Reserve begins system development. FedNow must be interoperable with RTP on day one, otherwise banks would be forced to operate duplicative real-time payment systems in order to service all of their customers. FedNow and RTP should start working today to enable interoperability. Interoperability will make both networks more attractive to the marketplace.

Chartered Financial Institution Access

Banks, as licensees chartered by federal and state authorities and regularly examined for compliance with regulations, are the only participants permitted to access the existing Fed payment systems by statute. This is appropriate due to the importance of protecting consumer funds, data, and privacy. Banks are held to high standards in those areas and also maintain capital reserves to ensure and offer deposit insurance

The Federal Reserve and Congress should protect consumers, financial institutions, and the payment system itself by strengthening the current laws and policies in place to protect consumers and the payments system.

Liquidity Management Tool (LMT)

An LMT would help financial institutions manage fund balances in a "real-time" environment. The private sector TCH RTP solution requires that banks participating in the service prefund their account. There is the possibility that some payments will not be completed if the prefunded balance drops to zero due to there being an imbalance in funds being paid out without offsetting incoming payments. If this happens overnight or on a weekend when Fedwire is closed, then outgoing payments cannot be made by the bank affected. We live in a world that does not stop at night or on weekends and our payment systems should reflect that fact.

The Federal Reserve should implement a 24x7x365 LMT solution as soon as possible. In fact there is no need to link this with FedNow development. The LMT would be a great asset to in-market faster payment solutions and moving the central bank to continuous payments processing is essential for modernizing the U.S. payments system.

Equitable Pricing

The Federal Reserve employs volume discounts for some current payment products like FED ACH. This means prices are lower for banks that transact in bulk while smaller banks with lower transaction volumes pay higher per-unit costs. The FedNow notice provided very little insight into the future pricing structure other than to state that more information would be made available closer to the implementation date in 2023 or 2024.

The Federal Reserve should provide more information regarding the proposed pricing structure and commit to a flat per-transaction pricing scheme without volume discounts.

Core Service Provider Oversight

Community banks rely on technology infrastructure that supports everything from accepting deposits to originating loans, all of which tie into operating the core ledger that keeps track of customer accounts. Three companies control the delivery of core services to approximately 80-90% of community and mid-size banks. Often products like FedNow must be integrated into the core service provider systems to allow banks to offer the service to its customers. This integration process can take time and delay implementation timelines for large technology projects like FedNow. Some core service providers are still working on partnerships with P2P services Zelle and TCH RTP. Implementation of these payment solutions has been slower than projected.

The Federal Reserve must work closely with, and provide close oversight of, the core service providers to ensure that they have all of the specifications and technical requirements they need, when they need it, to ensure that all banks have fair access to faster payments solutions within a reasonable amount of time at a fair cost.

Implementation Timeline

The FedNow notice projects that the first live transaction will take place in 2023 or 2024. This long period of time before processing makes FedNow a less attractive product. Banks that want to offer faster payment solutions to their customers sooner will opt for private sector solutions before FedNow goes live. Or, customers that want to participate in faster payments will move accounts to financial institutions that offer them that access immediately. There is also the possibility that some banks will wait for FedNow, ensuring that their customers will not be able to participate in faster payments for 3-5 years. This potential fragmentation harms the entire marketplace.

The Federal Reserve should strive to get FedNow operational and interoperable on a faster timeline to maximize the number of possible endpoints in the shortest time possible to leverage the network effect and to avoid the possible negative consumer experiences at banks that don't offer timely faster payment solutions.

Conclusion

Thank you for conducting this hearing on faster payments. Congress has the ability to influence the shape of FedNow so it can reach and benefit everyone in the United States within a reasonable amount of time safely and securely. We look forward to working with Congress, the Board, and all of the participants in the payments marketplace to ensure that the payment system becomes faster and stays safe.

STATEMENT OF THE CREDIT UNION NATIONAL ASSOCIATION

CUNA Credit Union National Association

Jim Nussle
President & CEO

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99 M Street SE
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September 25, 2019

The Honorable Mike Crapo
Chairman
Committee on Banking, Housing and
Urban Affairs
United States Senate
Washington, DC 20510

The Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing, and
Urban Affairs
United States Senate
Washington, DC 20510

Dear Chairman Crapo and Ranking Member Brown:

On behalf of America's credit unions, I am writing to express our views ahead of the hearing titled "Facilitating Faster Payments in the U.S." The Credit Union National Association (CUNA) represents America's credit unions and their 115 million members.

We thank the Banking Committee for holding this important hearing. Real-time payments will help credit unions provide necessary financial services to their members and improve members access to their funds. Credit unions exist to help their members but cannot do it alone. Credit unions rely on networks of key vendors to provide service to members and no current vendor is more critical than the Federal Reserve.

CUNA members strongly support the Board of Governors of the Federal Reserve System's (Federal Reserve Board) decision to develop and operate a real-time payments network that the Federal Reserve Board proposes to call FedNow. CUNA and our members have also supported The Clearing House's (TCH) efforts to develop their real-time payments network, which is called RTP. We think the efforts by the Federal Reserve Board and the TCH will help to bring real-time payments to consumers, who will benefit from the innovation and clarity of a faster payment system.

Although CUNA has worked closely with TCH over the course of several years as the organization has developed RTP we have also encouraged the Federal Reserve Board to develop a real-time payments network. There are several reasons why CUNA supports (at least) two real-time payments network operators and this Committee should share these same reasons if the continuation of America's vibrant financial institutions is an important goal.

From a pure public policy standpoint having multiple real-time payments networks will ensure a more robust banking system. As the plumbing of the payments systems is essentially a utility, having multiple operators will help make the system more robust against a cyber-attack or other unforeseen technical glitches. Also, competition breeds innovation, and not just in product features but in other aspects such as the security and robustness of the system.

CUNA's members' primary concerns with relying only on the TCH are more prosaic. Although, TCH has worked well with CUNA and our member credit unions in developing RTP, doing so is clearly in their best interest. The 25 or so banks that own TCH can dominate real-time payments policy and operation if TCH is the sole operator of a real-time payments network. Although TCH has created an advisory committee for credit unions and community banks, community institutions have no ownership of TCH and no voice in the operation of TCH. Absent the Federal Reserve Board or another entity operating a real-time payments network, the more than 10,000 credit unions and community banks that are not owners of TCH would be beholden through the TCH to the whims of TCH's bank owners. Our members find this unacceptable and clearly it would be business suicide.

Why trust the Federal Reserve Board?

Luckily both the Federal Reserve Board and TCH's current payments offerings clearly demonstrate why the Federal Reserve Board is a trusted partner in the delivery of payments. Both TCH and the Federal Reserve Board provide automated clearing house (ACH) payments services to financial institutions. TCH provides ACH services for a small percentage of financial institutions while the Federal Reserve provides these vital services to the other 10,000 financial institutions. Through experience in working with the Federal Reserve and Federal Reserve's demonstrated capability in providing service to the wide variety of financial institutions that do not use TCH for ACH, CUNA members feel confident that the Federal Reserve has the infrastructure and capacity to provide services to more than 10,000 financial institutions. TCH has not demonstrated this capability through any current or past product or service.

We acknowledge that TCH has committed that they will operate RTP as a "utility" with uniform pricing for users regardless of whether the user is a TCH owner. Unfortunately, TCH backed of this pledge in a public document. In that document TCH wrote that their commitment to charge uniform pricing is conditioned on TCH being the sole operator of the U.S. real-time payments network. We can only take TCH for their word in a written document. Further, we believe that this statement sheds light on the impermanency of a promise from TCH, especially from a vendor owned by competitors with a strong business incentive to work with all stakeholders while doing so suits their needs and likely only to last until competitors are vanquished.

We have heard concerns that the Federal Reserve Board's decision will freeze the market for TCH. We understand this concern as any properly functioning market would wait for a decision by the major player in the market. We are sure that the market would not freeze if the situation were reversed and the market had to wait for a decision by TCH. The Federal Reserve is the payments vendor most capable of developing real-time payments network and providing support to all financial institutions and thus a properly functioning market should wait for decision by the leader.

We acknowledge the FedNow's 2024 rollout seems far in the future. Nonetheless, we are encouraged by the Federal Reserve Board's outreach to key vendors necessary to help credit unions use FedNow. The Federal Reserve Board's commitment to develop FedNow in conjunction with credit union partners will help ensure a rapid rollout of FedNow to credit unions. Thus, working in conjunction with stakeholders at every step is key to making sure that 2024 date is the date that financial institution have access to FedNow and not the date in which stakeholders begin to build the necessary plumbing for access to FedNow.

CUNA looks forward to continuing to work with Federal Reserve Board leadership and staff on FedNow and will continue to support TCH's efforts as well. Nonetheless, the development of FedNow is imperative to the continued success of credit unions and community banks and is likely the only way that all credit unions will be able offer Americans of modest means critical financial services in the future.

Both TCH and the Federal Reserve are credit union vendors for payments clearing services. Currently one works with nearly all credit unions and banks while the other serves a small number of financial institutions. Having both vendors is a luxury but only the Federal Reserve is critical because they are the only vendor with the bandwidth and expertise to provide payments services to the entire financial services sector. Encouraging the Federal Reserve Board to leave real-time payments to TCH would cause the demise of many community financial institutions and deprive many Americans of the financial service provider that they know, trust and need.

On behalf of America's credit unions and their 115 million members, thank you for the opportunity to share our views.

Sincerely,

Jim Nussle
President & CEO

STATEMENT OF FINANCIAL INNOVATION NOW

Statement for the Record

Financial Innovation Now

Senate Committee on Banking, Housing, and Urban Affairs

September 25th, 2019

Financial Innovation Now (FIN) strongly supports the Board of Governors of the Federal Reserve System decision to develop FedNow, a real-time interbank gross settlement system that will facilitate faster payments across the United States.

FIN is an alliance of technology leaders working together on policies that will help modernize the way consumers and businesses manage money and conduct commerce.[1] Digital technology plays an essential role in the democratization of finance. FIN member companies have, in connection with financial institutions, brought to market some of the most innovative and secure financial products available to consumers and small businesses today.

The Federal Reserve Board's decision to develop FedNow is a bold step into the future. Real-time payments can increase economic efficiency, grow small businesses, and help American consumers keep up with everyday needs. FIN has long argued that sending money should be as fast and easy as sending a text message. That future will not come for all Americans unless the Fed acts swiftly to ensure wide adoption of a real-time payments infrastructure that serves the economy and public interest.

Federal Reserve action is necessary because: 1) consumers and small businesses, particularly the underserved, need accessible and affordable options, and they have twenty-first century expectations for their money; 2) innovation will flourish through two or more networks, helping to mitigate the harm of proprietary standards and rules; 3) while America's payment infrastructure is long overdue for an upgrade, other countries are outpacing the United States in adopting real-time payments; and 4) ubiquity can only be achieved by the Federal Reserve, which is uniquely positioned to connect all financial institutions in the United States.

FIN commends the Board's resolve and leadership in building part of the foundation necessary for America's future payment innovation. We look forward to working with the Federal Reserve on a timely process that benefits all payment system users and stakeholders. FIN urges Congress to support the Federal Reserve's work towards these goals.

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[1] Our member companies include Amazon, Apple, Google, Intuit, PayPal, Square, and Stripe. For more information regarding FIN's policy priorities and principles, please visit https://financialinnovationnow.org

STATEMENT OF FOOD MARKETING INSTITUTE

FMI
THE VOICE OF FOOD RETAIL
Feeding Families Enriching Lives

September 25, 2019

Chairman Mike Crapo
Senate Committee on Banking
239 Dirksen Senate Office Building
Washington, DC 20510

Ranking Member Sherrod Brown
Senate Committee on Banking
503 Hart Senate Office Building
Washington, DC 20510

Dear Chairman Crapo and Ranking Member Brown,

Food Marketing Institute[1] (FMI) was pleased to see the committee is holding a hearing, "Facilitating Faster Payments in the U.S." This is a very timely topic, and one that FMI has taken an active interest in over the past several years. We are very supportive of the Federal Reserve's recent announcement that it intends to move forward with implementing a real-time gross settlement (RTGS) system, FedNow. FMI is pleased to share our comments that we submitted as the Fed considered setting up a RTGS system last year, and we request they be submitted into the hearing record.

Thank you for your interest in faster payments here in the United States, and we look forward to working with the committee on this and other important issues to the food retail industry moving forward.

Sincerely,

Hannah vL Walker
Vice President, Government Relations

Cc: Members of the Senate Committee on Banking

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[1] Food Marketing Institute proudly advocates on behalf of the food retail industry, which employs nearly 5 million workers and represents a combined annual sales volume of almost $800 billion. FMI member companies operate nearly 33,000 retail food stores and 12,000 pharmacies. FMI membership includes the entire spectrum of food retail venues; single owner grocery stores, large multi-store supermarket chains, pharmacies, online and mixed retail stores. Through programs in public affairs, food safety, research, education, health and wellness and industry relations, FMI offers resources and provides valuable benefits to almost 1,000 ---food retail and wholesale member companies and serves 85 international retail member companies. In addition, FMI has almost 500 associate member companies that provide products and services to the food retail industry. For more information, visit www.fmi.org and for information regarding the FMI Foundation, visit www.fmifoundation.org.

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THE VOICE OF FOOD RETAIL
Feeding Families Enriching Lives

December 14, 2018

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

Re: Docket No. OP-1625; *Potential Federal Reserve Actions to Support Interbank Settlement of Faster Payments, Request for Comments*

Food Marketing Institute (FMI) is pleased to share its comments on the Federal Reserve Board's "Potential Federal Reserve Actions to Support Interbank Settlement of Faster Payments, Request for Comments." As the trade association representing the U.S. grocery and wholesaler industry, FMI thanks the Board for its continued interest in improving our payments system and active engagement with all stakeholders throughout the payments chain.

As a point of reference, FMI proudly advocates on behalf of the food retail industry, which employs nearly 5 million workers and represents a combined annual sales volume of almost $800 billion. FMI member companies operate nearly 33,000 retail food stores and 12,000 pharmacies. FMI membership includes the entire spectrum of food retail venues; single owner grocery stores, large multi-store supermarket chains, pharmacies, online and mixed retail stores. FMI members report that 32% of transactions in their stores are processed using credit cards, coming in only second to the 36% of transactions that were debit cards.

In 2017, according to *The Nilson Report*, 54.37% of all electronic transactions were processed using credit cards. In dollar figures, U.S. retailers accepted $3.597 trillion in credit card payments, up 7.3% from the prior year. While the increased use of credit cards in our members' stores have helped create some efficiencies for both the customer and grocer, many challenges remain. In addition to the continued and unchecked increase in cost of accepting credit cards, retailers are often left waiting multiple days before settlement and receiving payment for goods sold. While the grocery industry survives on a less than 2% profit, on average, this delay in settlement ties up billions of dollars trapped in transit between banks rather than being in a retailer's account to provide liquidity and resources needed to conduct and grow their business. Even more concerning is the growing disadvantage that delayed settlement is imposing on U.S. retailers in the global market. Once again, U.S. retailers find themselves at a competitive disadvantage while other countries move to innovate and implement real-time settlements. With the growth in e-commerce, this competitive disadvantage will only expand if it is not addressed now.

With these pain points in mind, FMI was pleased to see the Board's consideration in developing a 24x7x365 settlement service in order to implement real-time interbank settlement services. FMI also supports the implementation of the Real Time Gross Settlement (RTGS) model here in the U.S. Additionally, FMI supports the Board implementing add-on services, such as directories allowing users to use aliases or other credentials beyond account numbers. Time is of the essence, and FMI encourages the Board to move swiftly in building and launching a RTGS system without delay.

Launching a domestic RTGS system will have a clear public benefit, with the customer having real-time credit balance information and U.S. retailers with immediate access to funds and greater liquidity. Additionally, when a customer is issued a refund, he or she will have real-time access to those funds as opposed to waiting multiple days as they do today. Furthermore, we believe it is appropriate for the Board to implement this system, as no single private player in the market will achieve the ubiquity, scale and breadth demanded by our economy.

While FMI sees this as an essential first step to help our members continue to compete on the quickly evolving global market, we also see this as a first, not last step. FMI encourages the Board to continue to study other models across other markets including enabling non-banks to initiate payments using a common interface or set of open APIs, enabling even more robust competition and innovation.

In its request for comment, the Board thoughtfully asked what other ideas it should consider to achieve the broader goal of faster, ubiquitous payments. In that vein, we must look at the entire payments marketplace. Unfortunately, the U.S. payments industry lacks true competition, innovation and transparency, leaving legacy players content with the "status quo" of an unjustifiably expensive and antiquated payments system. FMI supports the Board, in addition to this work on real time payments, investigating the market inhibitors that have a chilling effect on competition and innovation. Building RTGS is a market-based approach, and we would encourage the Board to also consider leveraging its regulatory authority by revisiting Regulation II and further reducing the fee standard established by the Board to properly reflect the true costs of processing on behalf of the issuing banks and in turn spurring growth in competition and innovation.

Payments in the U.S. systematically lag behind our global competitors. In addition to the above topic of real-time settlement, the U.S. remains the global leader in payment card fraud. FMI is encouraged by the Board's interest in a multi-pronged approach to innovation that will address many of these pain points. Thank you again for the opportunity to share our thoughts on behalf of the grocery industry, and we look forward to a continued dialogue moving forward.

Sincerely,

Hannah Walker
Senior Director, Technology & Nutrition Policy

STATEMENT OF NACHA

Nacha

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Sept. 24, 2019

Via Electronic Submission

The Honorable Mike Crapo, Chairman
The Honorable Sherrod Brown, Ranking Member
Committee on Banking, Housing, and Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20510

Re: Hearing, "Facilitating Faster Payments in the U.S."

Dear Chairman Crapo and Ranking Member Brown:

Nacha appreciates the Senate Committee on Banking, Housing, and Urban Affairs's efforts to engage the payments industry in a dialogue about potential improvements to the U.S. payment system, particularly as it relates to faster payments. Nacha welcomes the opportunity to submit a Statement for the Record to the Committee in preparation for the Hearing on Facilitating Faster Payments in the U.S.

The Modern ACH Network

Nacha is the steward of the modern ACH Network, an electronic payment system that universally connects all U.S. bank accounts and facilitates the movement of money and information. The ACH Network serves as a safe and reliable way for consumers, businesses and governments to make and receive payments. In 2018, there were 27 billion ACH payments, and more than $51 trillion in value moved across the ACH Network. The Federal Government is the largest user of the ACH Network, making use of its capabilities and efficiencies for 1) the Direct Deposit of salaries and retirement benefits; Social Security, veterans and other benefit payments; and tax refunds; 2) the collection of much of the Federal government's revenue through the remittance and collection of tax payments; and 3) the payment of government vendors and contractors.

In 2016, Nacha and the two ACH Network operators – the Federal Reserve and The Clearing House – introduced Same Day ACH for faster processing and funds availability for ACH payments. Since its inception, the ACH Network has moved more than 400 million Same Day ACH payments; and in July 2019 the number of Same Day ACH payments exceeded 1 million per day. Additional improvements to Same Day ACH are coming – a faster funds availability requirement went into effect this month (on Sept. 20, 2019); the dollar limit for Same Day ACH payments will increase in March 2020 to $100,000; and extended operating hours are scheduled to go live in March 2021, pending a final decision from the Federal Reserve Board of Governors.

Nacha Comments on Faster Payments

A. A Misconception about Paychecks and Real-Time Payments

Much of the commentary surrounding the Fed's decision to build FedNow involves paychecks. There has been concern expressed that workers still getting paid by paper check don't have quick access to their funds, which can impact those living payday-to-payday. While paper paychecks are inefficient and should be replaced, most workers do not get paid with a paper paycheck anymore.

Direct Deposit via the ACH Network is the way in which nearly 93 percent of Americans get paid, according to a 2018 American Payroll Association survey. It's faster, safer and more reliable than a paper check, and can reach every bank account. Most importantly, by using Direct Deposit, workers get the money in their accounts at the opening of business on payday, without having to wait for a paycheck to clear. For example, an employee with a payday on Friday, Aug. 30, 2019, using Direct Deposit had their funds available for withdrawal or to cover payments at the start of that day, before the Labor Day holiday weekend.

For employees without set paydays, the ACH Network now enables faster processing of Direct Deposits with Same Day ACH. In the example above, the employee can still get access to money in his or her account by 5 p.m. via a Same Day ACH Direct Deposit. Direct Deposits and other disbursements to consumers are the largest and fastest growing category of Same Day ACH payments, increasing by 142% over the past year.

B. A Model for Interoperability

To the degree that real-time payment system operators desire interoperability, there is a model that exists today for how it can be successfully accomplished, administered and managed. The same two entities that are or will become real-time system operators are the same two entities that operate the ACH Network – the Federal Reserve and The Clearing House – and interoperability is achieved in large part through the Nacha Operating Rules.

Interoperability is about more than technology. Participants in any system need to know their roles, rights and responsibilities. A system need to define basic standard operating practices including risk management, error and dispute resolution, and regulatory compliance (for electronic payment systems, this includes Regulation E and

OFAC sanctions policies). Even a system design feature as simple as the maximum allowable amount of a payment can impact whether interoperability is achievable.

Nacha works cooperatively with the Federal Reserve and The Clearing House, as the two operators of the modern ACH Network, and with ACH providers, processors, end-users and other stakeholders to manage and administer the Nacha Operating Rules. Comment and feedback is solicited from the industry and the public with respect to proposed rule changes. Through this model of dialogue, comment, and consensus-building, Nacha and all ACH stakeholders are able to advance the capabilities of the ACH Network for the benefit of the consumers, businesses and governments that use the system.

C. The Payments Industry Needs More from the Federal Reserve than FedNow

Payments industry organizations and participants such as Nacha and WesPay have been asking for changes in Federal Reserve-provided settlement services for many years. In 2013, in response to the "Payment System Improvement Public Consultation Paper, Nacha wrote, "to support a 21st century payment system, the Federal Reserve could expand the opening hours of the National Settlement Service to support daily settlement activity with longer opening hours, ideally on a near 24x7 schedule, even on weekends and holidays." In its January 2015 Strategies for Improving the U.S. Payment System Report, the Fed committed to improving interbank settlement services based on industry feedback. Yet as of this writing on Sept. 24, 2019, the only service improvement implemented by the Fed later on the current date has been 30 minutes of extended National Settlement Service ("NSS") operating hours, from 5:00 p.m. to 5:30 p.m. ET.

To illustrate the impact of this limitation, ACH Operators process ACH files 23¼ hours per banking day (from 3 a.m. to 2:15 a.m. ET on the next day), but can only conduct interbank settlement when NSS and other Fed systems are open and available. If the Fed made NSS and other systems available for longer periods of time, the ACH Operators could conduct interbank settlement during a greater portion of each banking day. Similarly, although the private-sector ACH Operator conducts some ACH file processing on weekends, it cannot conduct interbank settlement until the Fed opens the NSS on the next banking day following a weekend and/or holiday. Again, if the Fed opened NSS for weekend and holiday hours for the current day's date, interbank settlement in support of ACH file processing could be available during those weekend hours.

Furthermore, the Fed has not committed as of this writing to implementing the industry's request to extend the NSS operating hours for an additional one hour – to 6:30 p.m. ET - to support the extension of Same Day ACH availability, even though Nacha and others have been in dialogue with the Fed for several years specifically on this point. More than a year after Nacha's rule to extend Same Day ACH was approved (on Aug. 22, 2018), the Federal Reserve has not agreed to provide the necessary settlement service.

Even in its proposal of Aug. 5, 2019 to build and operate the FedNow service, the Fed has not stated how it would enable banks and credit unions to manage their liquidity and fund their settlement positions during the times when FedNow is open and Fedwire is closed. FedNow will operate on a 7-day accounting regime that includes weekends and holidays, but evidently other Federal Reserve systems and services will not. This seems important and significant enough to the viability and success of the FedNow enterprise that it should be addressed in parallel with the proposal for FedNow, rather than being deferred for future discussion.

Nacha appreciates the opportunity to provide a Statement for the Record. If you have any questions regarding our comments, please do not hesitate to contact Nacha.

Sincerely,

Jane E. Larimer
President & CEO

STATEMENT OF THE NATIONAL ASSOCIATION OF FEDERALLY-INSURED CREDIT UNIONS

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September 24, 2019

The Honorable Michael Crapo	The Honorable Sherrod Brown
Chairman	Ranking Member
Committee on Banking, Housing & Urban Affairs	Committee on Banking, Housing & Urban Affairs
United States Senate	United States Senate
Washington, DC 20510	Washington, DC 20510

Re: Tomorrow's Hearing, "Facilitating Faster Payments in the U.S."

Dear Chairman Crapo and Ranking Member Brown:

I write to you today on behalf of the National Association of Federally-Insured Credit Unions (NAFCU) to share our perspective on the future of real-time payments in the credit union industry, and to express our support of the Federal Reserve's decision to develop a new, real-time gross settlement capability called 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.

Data collected by the Federal Reserve indicates that growth in both the value and volume of electronic payments has accelerated in recent years. At the same time, surveys of the largest depository institutions from 2016 to 2017 reveal that ATM withdrawals by number and check volume have declined. These trends are consistent with what has been a decades long shift towards digital payments—particularly remote and online payments—and have contributed to evolving consumer expectations regarding the speed and convenience of day-to-day transactions. Although real-time payments are not yet the norm for consumers, faster payments have become commonplace, particularly in the mobile and P2P space.

For credit unions, faster payments represent a distinct technology priority. Over half of the participants in NAFCU's 2018 Fed 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. While a majority of NAFCU-surveyed credit unions indicate that they are planning to invest in faster payments 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 in the future.

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, we are supportive of 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.

As the Committee considers ways that real-time payments may eventually shape consumers' financial habits, NAFCU notes that both industry and government stakeholders are already committed to ensuring that payments are not only faster, but also safer. NAFCU has served as a participant on the Federal Reserve's two payments improvement task forces, and credit unions have joined working groups that are actively exploring ways to improve the resilience and security of U.S. payments. The Committee should recognize that these efforts would be greatly enhanced by a national data security standard or equivalent legislation, which would help establish shared responsibility for protecting the sensitive, payment-related information of American consumers. While the creation of the FedNow Service will certainly improve the resiliency of U.S. payment systems as a backup in the event of system outages or other failures, the greatest threat to consumer payments safety is the lack of meaningful security standards among merchants. Credit unions continue to bear the costs of payment-related fraud in connection with retail data breaches. The nature of irrevocable, real-time payments suggests that this burden may only grow heavier in the absence of appropriate security incentives for merchant end-users.

Lastly, we ask the Committee to acknowledge that while the practical benefits of real-time payments are realizable, they should not be viewed as a panacea for underlying financial uncertainty. Faster payments can improve financial confidence by allowing individuals to make time-critical payments and avoid late fees with greater ease, but consumers must decide for themselves how best to manage their household liquidity. To improve understanding and adoption of faster payments, industry and government stakeholders should be given 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 stakeholders are empowered to determine best practices for access and disclosure based on experience rather than through the mandate of future legislation or regulatory intervention. Requiring a more prescriptive approach could chill adoption of faster payments and frustrate efforts to develop a modern and frictionless payment environment.

On behalf of our nation's credit unions and their more than 118 million members, we thank you for your attention to this important matter. Should you have any questions or require any additional information, please contact me at 703-842-2204 or bthaler@nafcu.org.

Sincerely,

Brad Thaler

Brad Thaler
Vice President of Legislative Affairs

Cc: Members of the Senate Banking Committee

STATEMENT OF THE RETAIL INDUSTRY LEADERS ASSOCIATION

RETAIL INDUSTRY LEADERS ASSOCIATION

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September 24, 2019

Honorable Mike Crapo
Chairman
Committee on Banking, Housing and Urban Affairs
United States Senate
543 Dirksen Senate Office Building
Washington, D.C. 20520

Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing and Urban Affairs
United States Senate
534 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Chairman Crapo and Ranking Member Brown:

The Retail Industry Leaders Association (RILA) supports the recent announcement by the Board of Governors of the Federal Reserve to establish a faster payment system in the United States and appreciates the Senate Committee on Banking, Housing and Urban Affairs holding a hearing on *"Facilitating Faster Payments in the U.S."* RILA welcomes the opportunity to partner with the Committee as the FedNow infrastructure is developed. The engagement by the Federal Reserve will help achieve ubiquitous, safe, and efficient faster payments across the ecosystem and, more importantly, benefit all Americans.

RILA is the U.S. trade association for leading retailers. We convene decision-makers, advocate for the industry, and promote operational excellence and innovation. Our aim is to elevate a dynamic industry by transforming the environment in which retailers operate. RILA members include more than 200 retailers, product manufacturers, and service suppliers, which together account for more than $1.5 trillion in annual sales, millions of American jobs, and more than 100,000 stores, manufacturing facilities, and distribution centers domestically and abroad.

During the past few years, RILA has been a collaborative partner with the Federal Reserve by working with the Secure and Faster Payment Task Forces (SPTF and FPTF). These efforts brought industries from across the payment ecosystem together to discuss a wide range of policy issues, with the overall goal of updating and improving the nation's payment infrastructure. These efforts culminated in the decision to establish FedNow.

FedNow will not only have a positive impact on the merchant community, but it will also benefit the American consumer. As retailers, it is not uncommon to hear from our customers about the length of time it takes for debit transactions to be completed. This is especially true for

Americans who are underbanked, living on fixed incomes, and facing budget constraints. Establishing a real time payment system in the United States would benefit all American consumers by providing more clarity and control over their finances.

Over the past several decades, RILA has seen competition and innovation in the payments ecosystem stifled by a small group of legacy players. This is one of the key reasons why RILA supports the Federal Reserve's involvement. The Federal Reserve's decision to move forward on FedNow would not only complement the current services they provide in the payments arena but also—and more importantly—ensure there is competition in the market that provides a choice for all industries.

Once again, RILA commends the Federal Reserve's decision to establish FedNow, which will ensure scale, reach, and competition are achieved for faster payments in the United States. There will undoubtedly be policy disagreements as the FedNow infrastructure is created, but there should be no dispute that the Federal Reserve has the clear authority to engage in this area.

RILA is prepared to work as a collaborative partner to achieve this ambitious undertaking with all Members of Congress, key stakeholders in the payment ecosystem, and the Federal Reserve. Failure to move forward on this critical initiative will leave our nation further behind in the payments arena, potentially harm economic growth, and—above all—limit the financial choices of the American public.

Sincerely,

Austen Jensen
Senior Vice President, Government Affairs

cc: Members of the Committee on Banking, Housing and Urban Affairs