

December 14<sup>th</sup>, 2018

Ann E. Misback

Secretary, Board of Governors of the Federal Reserve System

RE: Docket No. OP-1625; Potential Federal Reserve Actions to Support Interbank Settlement of Faster Payments

Dear Ms. Misback:

The Payments Risk Committee (“PRC”) appreciates the opportunity to provide comments to the Board of Governors of the Federal Reserve System (“Board”) in response to its request for comment (“FR Notice”) about potential actions that the Federal Reserve could take to promote ubiquitous, safe, fast and efficient payments in the United States.

The PRC is a private-sector organization sponsored by the Federal Reserve Bank of New York. The PRC’s membership, drawn from financial firms, meets at regular intervals to identify and analyze risk issues in payments, clearing, and settlement (PCS) of financial transactions.<sup>1</sup> The primary goal of the PRC is to foster enhancements to the safety and efficiency of financial market infrastructure, which includes identifying opportunities to strengthen the clearing and settlement of financial transactions, and to inform the Federal Reserve about developments, conditions, and practices in PCS activities.

The views expressed in this document are the views of the PRC only. Nothing herein reflects official views of the Federal Reserve Bank of New York, the Board of Governors of the Federal Reserve System, or any other entity within the Federal Reserve System.

We appreciate the opportunity to comment on the important issues addressed in this FR Notice. The PRC would welcome an opportunity to work with the Board to further develop the recommendations presented below and to advance the interests of the payments industry in promoting adoption of ubiquitous, safe and efficient faster payments in the United States. If you have any questions, or wish to discuss this letter, please contact the PRC Secretariat ([PaymentsRisk.Committee@ny.frb.org](mailto:PaymentsRisk.Committee@ny.frb.org)).

Yours sincerely,



Emma Loftus  
Chair, Payments Risk Committee  
Managing Director, Treasury Services, JPMorgan

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<sup>1</sup> The current members of the PRC represent Bank of America N.A., The Bank of New York Mellon, Citibank N.A., Deutsche Bank AG, Goldman Sachs, HSBC Bank USA, JPMorgan Chase, Morgan Stanley, MUFG Bank, State Street Bank and Trust Company, UBS AG, and Wells Fargo. More information on the PRC and its members is available at: <http://www.newyorkfed.org/prc>.

### Focus of the PRC comments –

The PRC recognizes the divergent viewpoints in the market on the possibility of the Federal Reserve Banks (“FRB”) serving in a clearing/operator role for faster retail payments. We will leave it to our industry colleagues who have strong views on this issue to provide commentary on the relative merits of the Reserve Banks taking such action.

Given the remit of the PRC and its view that interbank payment system settlement is both a core responsibility of the Federal Reserve (as the central bank in the U.S.) and a critical component in maintaining the safety, soundness, and efficiency of payment systems, the PRC comments will focus on the interbank settlement aspects of a real-time payments ecosystem in the U.S. and the proposed liquidity management tool.

### Gross Real-time Settlement –

Gross real-time interbank settlement using balances at the Federal Reserve (referred to as central bank money) is advanced as the preferred settlement methodology in the FR Notice. The Federal Register Notice describes this settlement process as “vital not only to the smooth functioning of the payment system but also to financial stability more broadly”.

The PRC agrees that this settlement methodology has unique attributes which are beneficial to the market. However, the PRC would also observe that for “wholesale”/RTGS systems, many, if not most, systemically important FMIs in the U.S. and around the world find it safe and efficient to use some combination of gross settlement in commercial bank money and/or deferred net settlement in either central bank or commercial bank money.<sup>2</sup> Indeed, as the FR Notice itself observes, real-time gross settlement for retail payments may require more liquidity and closer management of account positions than deferred net settlement systems. Accordingly, the PRC encourages the Federal Reserve to assess more thoroughly the liquidity implications of alternative settlement models in framing its recommendation.

With respect to the faster payments ecosystem in the United States, the PRC observes that an established private sector alternative – The Clearing House’s Real Time Payment System (TCH RTP) -- appears generally to satisfy the stated preference for a real-time settlement capability on a 24/7/365 basis on a private sector-owned settlement ledger. The ledger is backed by funds in a “joint account” which is held at a Federal Reserve Bank and holds balances for the joint benefit of settling banks/participants in the service.<sup>3</sup>

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<sup>2</sup> As noted by CPMI-IOSCO, “an FMI [Financial Market Infrastructure] should conduct its money settlement using central bank money, where practical and available, to avoid credit and liquidity risks. If an FMI uses commercial bank money for its money settlements, it should monitor, manage, and limit its credit and liquidity risks arising from the commercial settlement bank.” See paragraph 3.9.3 and 3.9.5 of the CPMI-IOSCO *Principles for financial market infrastructures*, available at <https://www.bis.org/cpmi/publ/d101a.pdf>.

<sup>3</sup> The PRC observes that a systemically important private sector funds transfer system operating in the U.S., The Clearing House Interbank Payment System (CHIPS®), currently has utilized the joint account settlement model for years without incident. Funds of CHIPS participants are held in a joint account at the Federal Reserve Bank of New York and CHIPS maintains a ledger to record changes to its participants’ positions throughout the operating day.

### Liquidity management tools –

The current FRB infrastructure would be unable to support unexpected off-hour liquidity needs of faster payments. For example, the Fedwire Funds Service operates 21.5 hours each business day (Monday through Friday except holidays) beginning at 9:00 p.m. Eastern Time (ET) on the preceding calendar day to 6:30 p.m. ET. Participants would be unable to transfer liquidity (e.g., to a joint account backing a faster payment system) outside of these operating hours. Furthermore, as noted in the FR Notice, the benefits to the participants of a separate account include the ability of participants to allow a third party to manage liquidity positions by initiating transfers on their behalf, but these transfers by a third party would only be possible with the enhancement of existing critical FRB infrastructure.

The PRC does not believe that a new type of liquidity management tool necessarily needs to be developed. Instead, the PRC encourages the FRB to consider enhancing the availability of existing critical FRB infrastructure with these possibilities:

1. Extend the Fedwire Funds service operating hours to include weekends, U.S. holidays and, potentially, additional evening hours on business days.

With these additional operating hours, Fedwire Funds would be an effective channel to enable transfers between Federal Reserve accounts, both between individual master accounts of financial institutions and between individual master accounts and the “joint account” established to support real-time interbank settlement of faster payments.

Banks that participate in extended Fedwire operating hours will need to make staffing decisions to support the extended hours. Banks should therefore be offered a choice to “opt in” to the extended processing hours window. This feature will allow banks to leverage the extended hours if and when the volume of real-time payments it processes reaches levels that justify adoption of the extended hours.

An alternative to adding staff during weekends, U.S. holidays, and additional evening hours could be an automated liquidity transfer capability described in the FRB proposal. This capability offers the option for a bank to fund a real-time position with minimal staff coverage. When a real-time payments position is low (e.g. the balance in the RTP joint account goes below a certain level), the automated liquidity transfer capability will immediately transfer a predetermined amount from a bank’s Federal Reserve master account to a dedicated faster payments settlement account. The liquidity transfer capability could be permitted to draw on all available balances in the master account and any available overdraft capacity.

Ultimately, the PRC does not want to limit the availability of Fedwire Funds during these extended hours to bank-to-bank transfers for the purpose of funding faster payments positions. The PRC sees significant benefit in extended Fedwire Fund operating hours for all transfers, including customer transfers. In fact, there has been a “brainstorming” dialogue within the PRC on the potential value of extending the hours of the Fedwire Funds service so that U.S. banks which provide U.S. dollar

clearing services to global correspondents and multinational corporations may meet their clients' payment requirements during weekend and U.S. holiday periods. Today, many of these payment requirements are provided by off-shore service providers.

The extension of the Fedwire Funds service for customer transfers is an intricate, complex initiative, and requires further dialogue between the Federal Reserve and the banking industry and a comprehensive assessment of the operational and service considerations. While the PRC considers a move to 24x7 coverage for Fedwire Funds to be the desired end-state, it should be noted that an alternative which includes incremental hours and the availability of weekend or holiday coverage provides significant benefits. The PRC believes that the benefits to the U.S. and global market are compelling and strongly recommends that the Federal Reserve and the industry develop this assessment. Key benefits include –

- I. Support international settlement shifting towards 24x7 – as demand for cross-border 24/7 payments increases (driven by e-commerce and globalization), a 24/7 Fedwire Funds service will help ensure that the USD continues to play a substantial role in international trade/settlements.
- II. 24/7 Fedwire Funds would offer financial services ecosystems, both domestic and international, substantial benefits beyond supporting faster payments settlement, such as improved liquidity and risk management in support of cross-border transactions.
- III. Due to the international nature of USD, a 24/7 Fedwire Funds service would offer efficiency for foreign markets operating in time-zones or geographies where normal activity takes place during “off” hours (e.g. Asia) or “off” days (e.g. Middle East) than in the U.S., and mitigate risks that the dollar's role as a global settlement currency will erode over time.

Using an extended hours Fedwire Funds platform as the liquidity management tool for real-time interbank settlement of faster payments represents a critical support for settlement of faster retail payments. The PRC believes that by considering the use of extended Fedwire Funds hours broadly, on an opt-in basis, to meet both industry requirements – 1) a liquidity management tool to support faster domestic retail payments and 2) an extension of service to support global customers – provides maximum strategic value to the U.S. and global payments markets. The PRC believes the extension of Fedwire Funds to 24x7 represents the preferred end-state to support domestic and international USD payments.

## 2. Enhance the National Settlement Service (NSS)

While acknowledging that the preferred option for the PRC is to extend the Fedwire Funds service as described above, the PRC recognizes that extended hours may be viewed as an operational and staffing challenge by several banks in the U.S. market. For banks choosing to “opt-out” of the extended hours Fedwire Funds service, the PRC recommends that the Board consider enhancements to NSS that would reduce the liquidity risk associated with a real-time settlement model. This could be accomplished by allowing for scheduled or “on demand” file submissions to settle real-time

positions throughout the processing day and into the evening during non-standard hours, as well as during weekends and U.S. holidays. The establishment of payment thresholds and limits will also improve risk management capability.

Use of NSS as a liquidity management tool to fund joint accounts which support a real-time payments service reduces the liquidity risk associated with a real-time interbank settlement model, potentially easing the operational burden for many banks that use such accounts to participate in faster payment services and enhancing prospects to achieve the “ubiquity” objective for faster payments.

In closing, the PRC wishes to emphasize that its preferred liquidity management solution to support settlement of faster retail payments is the ultimate extension of the Fedwire Funds service operating 24/7/365 for all transfer types, including customer transfers. This is a strategic priority for the PRC. The NSS proposal is presented as an acknowledgement that some segments in the U.S. bank market may view an enhanced NSS as the preferred alternative. If the ongoing assessment indicates that there is market support for both solutions, and the complexity and operational risks associated with two liquidity management solutions are adequately addressed, both solutions may be developed and would help improve the overall safety and efficiency of USD payments and support achievement of the ubiquity objective for faster payments.