Financial Services Management

Faster U.S. Payments

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H.R. 3951 and S. 2243, Payment Modernization Act of 2019; H.R. 3928; H.R. 3939

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Impact Assessment

- Although the Fed has now decided to enter RTP, Democratic legislation may still advance to force faster, broader service and a still larger Fed role.
- GOP legislation pushes back with speed-bumps ahead of full Fed entry.
- Banks could be forced to provide RTP immediately even in the absence of a Fed system. Private-sector competitors could benefit in the interim and/or more payment could migrate to tech-platform companies.

Overview

Ahead of the Federal Reserve's decision on August 5 to own and operate a real-time payment (RTP) system,[1] controversy about its role ramped up to the point at which Democrats introduced legislation to push the Fed to take an owner/operator role. On the other side, Republicans have pushed back in favor of at least some additional steps protecting private RTP providers. This debate pits community banks, merchants, and large tech-platform companies – which want the Fed to control faster payments – against large banks and the RTP system they have developed. The Democratic bill would also force banks to ensure real-time payments, perhaps accelerating use of private-sector RTP services given that the Fed does not believe its "FedNow" service will be even preliminarily operational until 2023 or 2024. Tech-platform companies working on real-time offerings through banks or on their own could also expand activities, especially if they fear that the FedNow system will block direct entry.

1 See forthcoming FedFin report.

Impact

In its 2015 faster-payment policy statement,[2] the Federal Reserve laid out an RTP vision in which it would stay aloof from an owner/operator role unless it became clear that private capacity could not achieve the ubiquity, efficiency, and security goals established in the policy statement. Fed entry is also determined by provisions in the 1980 Monetary Control Act which among other things requires that any Fed payment-system offering complies with a "private-sector adjustment factor" (PSAF) calculated so that the Fed does not offer payment services on preferential terms that suppress private competition.[3] Opponents to Fed entry believe that the 2015 commitment bars the Fed from deciding now to own or operate an RTP provider because the private sector has stepped up with a service from The Clearing House. They also contend that scrupulous adherence to the PSAF would make it challenging for the Fed to extend introduction of FedNow for an extended period of time with pricing that recoups its initial investment and a reasonable return on the equity private companies need to invest in like-kind systems. The two House bills described above build on these concerns to demand a series of reports on the extent to which Fed entry adheres to prior commitments and the 1980 Act and on the quantitative and policy impact of a Fed-owned RTP system along with numerous other assessments of the Fed's ability to ensure fraud protection, cybersecurity, and personal privacy.

However, the Federal Reserve has now sided with at least some aspects of the Democratic bill. It has announced that it will use what it believes to be its clear statutory authority to offer the FedNow service. It plans also to update its current services to facilitate faster payments as the RTP system is implemented. As noted, the Board expects FedNow to go live no sooner than 2023 or 2024 and it has also made it clear that, even then, truly ubiquitous operations will take more time and complete inter-operability with private providers is uncertain. The Democratic bill presses the Fed to move far more quickly; conversely, GOP critics will point to this timeline and possible implementation hurdles to counter FedNow on grounds that its main result will be to discourage private-sector innovation.

Democratic support for Fed entry is premised on the view that faster payments and even the payment system as a whole are such overwhelming "public goods" that only government control akin to a public utility suffices. The Democratic bill does not bar private competition, but it also states that the Fed must govern RTP as a public utility that meets various public purposes (e.g., service to those not necessarily in the banking system) and price to challenge private competitors. The PSAF is not repealed, but the incompatibility of private-sector pricing and utility obligations is likely to lead a Fed under edicts of this sort to price to serve its understanding of mission, not to protect the competitiveness of private RTP systems. Although the Democratic bill is generally focused on RTP, its drafting often focuses on the payment system as a whole. To the extent the public-utility mandate is read to apply across the payment system, then even private providers outside RTP could face a significant challenge.

Further the bill not only presses the Fed to take the step it subsequently announced with FedNow, but also revises provisions in the Expedited Funds Availability Act (EFAA) to force banks to make deposited funds available in real time seemingly as early as the date of enactment. It is left unsaid how depository institutions are to do so in the absence of a Fed RTP system other than through the

2 See **PAYMENT15**, *Financial Services Management*, February 3, 2015.

3 See *Client Reports* in the **PSAF** series.

current private-sector RTP provider the bill assumes to be inimical to the public good. Another alternative might be through the payment systems tech-platform companies contemplate either through bank partners, services such as Venmo overlaid on the banking system, or via their own (e.g., Libra-style) services. Payor, bank, and even systemic risks could increase to the extent that banks are forced to make funds available in real time in the absence of effective fraud prevention, cybersecurity, liquidity, and other safeguards.

RTP would under any circumstances reduce the billions consumers now pay in overdraft fees due solely to belated crediting of deposited funds. However, real-time payments without simultaneous creation of a real-time payment system that ensures finality and effective fraud and liquidity protections could create significant risks if payor funds are disbursed based on paid-in funds provided in error or via fraud. To address this, the Democratic bill requires the Fed not only quickly to offer RTP, but also to build-out current infrastructure to facilitate faster payments through its own infrastructure. The Fed has subsequently announced its plans to do so and seeks comment on this; the legislation would press the point far more quickly than the Fed seems willing to do and, as a result, perhaps make its mandate for bank RTP less risky.

Consistent with current law, the Democratic legislation specifies that the Fed's RTP system is to be an interbank one. This would appear to bar tech companies from entry and, to the extent that the Fed's RTP becomes a utility that drives out private competition, force these companies to use banks to access the payment system instead of doing it themselves with new payment instruments. When releasing FedNow, the central bank indicated considerable concern about payments outside the regulated interbank sector and suggested no plans to allow tech-platform companies independently to access the new RTP service. To the extent tech companies obtain banking licenses, they could bypass traditional financial intermediaries for payment-system purposes, sharply reducing current interchange fees and other costs. Tech-company banking portals into the payment system could facilitate efficiency and innovation, but the extent to which liquidity and other risks are created in the absence of parent-company, consolidated regulation is at best uncertain. This regulatory asymmetry could give tech companies considerable advantages over traditional banks despite the need to use a banking franchise to enter and exit the Fed's payment system.

What's Next

The Fed released its FedNow plans on August 5. Comments on its request for views are due ninety days after publication in the *Federal Register*, suggesting no Board action until at least early 2020. In 2015, the central bank committed to RTP by 2020. It is sure to move as quickly as possible now, but it has also already recognized numerous impediments to a truly ubiquitous system for years after initial launch.

As a result, the legislative debate may take on urgency for those who believe that faster payments provide important relief from overdraft fees and high-cost, short-term loans. H.R. 3951 was introduced by Reps. Ayanna Pressley (D-MA) and Jesús "Chuy" García (D-IL) on July 24; S. 2243 was introduced the same day by Sens. Chris Van Hollen (D-MD) and Elizabeth Warren (D-MA). After the FedNow announcement, HFSC Chairwoman Waters (D-CA) indicated that her panel will hold an RTP hearing in late September with an eye to future legislative action along the lines of the Democratic bill as introduced.

H.R. 3928 was also introduced on July 24 by Rep. Denver Riggleman (R-VA); H.R. 3939 was introduced the same day by Rep. Ted Budd (R-NC).

There has otherwise been no action on any of these bills, but the issues covered by them have been discussed at the House semi-annual monetary-policy hearing with Chairman Powell[4] as well as the Senate's companion session.[5] Democrats also focused on the role of big tech and big banks in the payment system during Senate Banking hearings on Libra[6] and crypto-assets.[7] It remains to be seen if payment-system legislation advances, but action to press a Fed role appears most likely in the House. Senate legislation to constrain the Fed is possible, but appears challenging given strong opposition by senior Senate Banking Committee Democrats to any such initiative and no indication to date of any interest by Chairman Crapo (R-ID) in advancing such a bill.

Analysis

I. House/Senate Democratic Legislation

A. Findings

H.R. 3951 and S. 2243 are based on conclusions that faster payments would be of significant benefit to lower-income households, with savings of "billions of dollars" likely due to reduced overdraft fees and less reliance on high-cost, short-term loans. International competitiveness is also cited as an assertion that the Fed's mandate expressly requires it to implement a faster payment system as quickly as possible. The bill asserts that the Fed' statutory mission in fact requires it to ensure payment services to all depository institutions on an "equitable basis and in an atmosphere of competitive fairness."

The bill's findings also assert that the Monetary Control Act and Expedited Funds Availability Act give the FRB full authority to govern the U.S. payment system as a whole. The bill also details its purposes including:

- a safe, fast, equitable, and fair U.S. payment system to be created by the Fed;
- clarification of the Fed's authority to build a real-time payment system; and
- an instruction for the Fed to follow through to create the desired payment system.

B. Real-time Mandate

The bill creates a statutory definition of the term "real-time," defining this to mean any time including Saturdays, Sundays, and legal holidays and applying it in place of current next-business-day (or longer) requirements governing the availability of deposited funds

4 See *Client Report* **FEDERALRESERVE50**, July 10, 2019.
5 See *Client Report* **FEDERALRESERVE51**, July 11, 2019.
6 See *Client Report* **VC9**, July 16, 2019.
7 See *Client Report* **CRYPTO11**, July 30, 2019.

and establishes a new permanent availability schedule. Deposited funds would have to be available for withdrawal in real-time instead of on a next day basis as is now the case for most deposits. Further, current close-of-business (i.e., 5:00 pm) cash availability and amount requirements governing deposited funds would be eliminated.

In addition, the Fed would be required to create an RTP system that at a minimum conforms to the principles described above and those also contained in the Board's payment-system report. The system would need to operate as a utility that reaches the unbanked, cross-border users, and others not necessarily in the for-profit payment system. Volume discounts would be barred and values such as consumer self-sufficiency would need to be served.

C. Timing

There are no effective dates in the bill. If enacted, this would mean that the changes to current funds-availability deadlines would immediately convert to real-time ones. This could create significant operational stress across the financial system.

II. Republican House Legislation

A. Transparency

H.R. 3928 would not bar the Fed from becoming an RTP owner/operator, but demands transparency from it should the central bank decide to do so. The transparency edict focuses on the Fed's 2015 commitment to enter faster payments only under certain circumstances (e.g., insufficient private-sector capacity), demanding that the Fed explain how any entry comports with prior statements.

B. QIS

H.R. 3939 would require the Fed to carry out a comprehensive study, including a quantitative impact study, of any planned real-time payment system prior to implementation, including even with regard to preliminary development of its own system. Indeed, any aspect of Fed faster-payment system development, including with regard to liquidity or ancillary services, could not proceed for one year after the QIS was submitted to Congress. This could delay not only FedNow, but also liquidity-risk backstops and changes to the Fed's existing system and other actions to enhance payment speed short of a Fed-owned system.

Laying groundwork for a broader challenge to the Fed, the bill asks for the central bank's views on questions such as its cyber resilience, governance under various laws germane to consumer rights and privacy, private-sector capacity, and the extent to which the Fed could achieve faster U.S. payments by improving its existing infrastructure.

Federal Financial Analytics, Inc.
1255 23rd Street, N.W., Suite 500, Washington, D.C. 20037
Phone: (202) 589-0880
E-mail: info@fedfin.com Website: www.fedfin.com