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INSIGHT

Real Time Payments Initiatives

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Technological advances have made it feasible to create a *real time payments* (RTP) network between financial institutions in which the recipient of an electronic payment would receive funds in seconds, compared to the current practice of later in the day or the next day. The Federal Reserve's (Fed's) recent announcement that it would create a RTP system has been controversial, as it will be directly competing with a privately owned system.

Background

This Insight discusses payment and settlement systems that allow individuals and businesses to complete payments across different financial institutions and platforms. To simplify, a payment has three parts. First, the payer initiates the payment through an *end-user service*, such as an online payment service or mobile app, instructing a bank to make a payment to the recipient. (The payer and recipient only interact with end-user services.) Second, the payer's bank sends a *payment message* involving the payment details to the recipient's bank through a payment system. Finally, the payment is completed when the two banks transfer funds through a settlement system. These parts could be divided between different systems, and different providers could compete with each other to provide each part. RTP initiatives involve speeding up each step of the payment process.

The Fed has long operated its own payment and settlement systems connecting banks and selected other financial institutions through their Federal Reserve accounts. It also regulates competing systems that are privately operated. (The Fed does not operate any end-user service directly accessed by individuals or nonfinancial businesses.)

On August 5, 2019, the Fed announced plans to introduce FedNow, "a new interbank 24x7x365 real-time gross settlement service with integrated clearing functionality to support faster payments in the United States," in 2023 or 2024, with "nationwide reach" taking longer to achieve. FedNow will provide the payment message and settlement steps of a payment described above. It will be available to all banks with a reserve account at the Fed, and banks will be required to make those funds available to their customers immediately after the bank is notified of settlement.

In the August notice, the Fed stated it was also exploring expanding its existing settlement services to permit 24x7x365 real-time gross settlement to accommodate the need in real-time settlement for banks to

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move funds between accounts continuously and outside of business hours. Previously, the Fed proposed expanding same-day payments settlement on these services.

Several private-sector initiatives are also underway to implement faster payments. Notably, the Clearing House, an association of large banks, introduced its RTP network in November 2017; according to the Clearing House, it currently "reaches 50% of U.S. transaction accounts, and is on path to reach nearly all U.S. accounts in the next several years."

The Fed or private-sector companies can also set joint standards, rules, and a governance framework to facilitate the adoption of faster payments, whether those systems are operated by the Fed or the private sector. The Fed convened the *Faster Payments Task Force*, composed of more than 300 stakeholders, which has issued a number of recommendations to facilitate the adoption of faster payments.

Policy Issues

According to Fed Chair Jerome Powell, "the United States is far behind other countries in terms of having real-time payments available to the general public." Businesses and consumers would benefit from the ability to receive funds more quickly, particularly as a greater share of payments are made online or using mobile technology. Some have argued that RTP would be especially beneficial to low-income or other liquidity-constrained households.

Stakeholders are divided over the creation of FedNow. The Fed justified its decision on the grounds that it would cover costs in the long run, yield a clear public benefit, and the private sector alone cannot provide a comparable service. Each point has been debated. Some fear that FedNow could hold back or crowd out private-sector initiatives already underway and could be a duplicative use of resources. Others, including small banks, fear that aspects of payment and settlement systems exhibit some features of a natural monopoly, and in the absence of FedNow private-sector solutions could result in monopoly profits or anticompetitive behavior, to the detriment of financial institutions accessing RTPs and their customers (merchants and consumers). In 2017, the Justice Department sent the Clearing House a letter stating that it did not plan to challenge the Clearing House's RTP system on antitrust grounds, based on the Clearing House's plans at that time. From a societal perspective, it is unclear whether it is optimal to have a single provider or multiple providers in the case of a natural monopoly. Multiple providers could spur competition that might drive down user costs, but more resources are likely to be spent on duplicative infrastructure. Multiple providers also have ambiguous effects on innovation, ubiquity, equity, and security. A key question is whether the two systems will be interoperable—which the Fed has not committed to.

RTP offered by the private sector could fit into the existing regulatory framework. The Fed already regulates and supervises payment systems for risk management and transparency, but not pricing. RTP could alleviate some existing risks (for example, if settlement is in real time, credit risk is reduced for the recipient institution) while posing new risks (for example, RTP requires more active liquidity management). Any RTP system and regulation would need to account for these changing risks. In addition, an RTP system could be designated as a systemically important Financial Market Utility (FMU) by the Financial Stability Oversight Council on the grounds that "the failure of or a disruption to the functioning of the FMU could create or increase the risk of significant liquidity or credit problems spreading among financial institutions or markets and thereby threaten the stability of the U.S. financial system." FMUs are subject to heightened regulation and supervision. Policymakers could consider whether systemic risk concerns are better addressed through Fed operation of payment and settlement systems or Fed regulation of private systems.

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