

September 9th, 2021

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

RE: Collection of Checks and Other Items by Federal Reserve Banks and Funds Transfers Through Fedwire; Regulation J: Document ID R-1750, RIN 7100-AG16

Submitted by electronic mail to regs.comments@federalreserve.gov

Dear Ms. Misback,

We, the undersigned, thank the Federal Reserve Board (the “Board”) for this opportunity to provide input on the Notice of Proposed Rulemaking concerning Collection of Checks and Other Items by Federal Reserve Banks and Funds Transfers Through Fedwire, which contains proposed changes to Regulation J in support of the development of the Federal Reserve’s planned 24x7x365 real-time gross settlement service FedNowsm (the “Notice”). As a diverse group of industry and consumer stakeholders of the payments ecosystem, we are excited for this opportunity to provide our perspective.

This letter, while not formally endorsed by the FPC, is supported by many different members of the FPC with representation across nearly all of the industry segments (Consumer Groups, Merchants, Banks and Technology Providers).

The advent of FedNowsm will introduce an integral part of the infrastructure for faster payments in the United States, and thus has the potential to impact adoption, user experience, and public confidence, both positively and adversely, depending on the choices made in designing the system. As described below, we support the Fed’s efforts and recognition of the need to craft rules to govern the operation of FedNowsm and expectations of FedNowsm participants and end users, as clear and specific rules are critical to the broad adoption of FedNowsm by all stakeholders, including consumers, business end users, and financial institutions. However, we have concerns about the need for clarity on a wide variety of topics including security, red flags for fraud and error, error resolution, and clear delineation of what law and rules will apply. The below comments explore, among other things, the Board’s proposed interplay between the Electronic Funds Transfer Act/Regulation E and Uniform Commercial Code Article 4A as applied to FedNowsm transactions and highlight a number of areas wherein we believe additional consideration is due to ensure adequate clarity and specificity to achieve the Board’s goal of a secure, trusted system. Additionally, we believe the process for developing subsequent rules through operating circulars is important to all stakeholders, and we provide input below regarding our perspective on that issue as well. While we agree it is crucial for the Board to adopt rules governing FedNowsm well before the service is commercially available, we believe that the Board should ensure adequate time is taken during the process for thorough development of, and understanding regarding, the rights and obligations of the end users of the FedNowsm service as well as the parties that will ultimately make the service available to end users, including financial institutions, financial technology companies, service providers, and business end users.

Part One: Background

The undersigned authors consist of a group of stakeholders representing organizations from across the entire range of the payments ecosystem. Accordingly, we believe the views expressed in this letter demonstrate a consensus view that the proposed Regulation deserves further refinement. These challenges include issues of trust and safety, which must be understood and addressed to ensure end user confidence in any new payments system. While unauthorized transfers as defined in the EFTA and UCC 4A, fraudulently induced payments, and the range of errors that can occur may in some cases be distinct types of issues, reports of fraud and errors, and particularly the inability to correct those issues, resulting in consumer losses, have the potential to undermine confidence in faster payments systems.¹ Thankfully, the Federal Reserve's FraudClassifiersm model provides a framework by which these different types of problems can be categorized and thus handled appropriately.² These issues of interoperability, the cost and complexity of implementation, and end-user protections are also highly relevant as the Board considers finalizing changes to Regulation J. When possible, aligning with market practices already in use could potentially promote interoperability, help to reduce the expense and complexity of implementation, and provide consistency in terms of safety and security across providers.

We also hope that this is only the beginning of an iterative approach to continually balancing a variety of interests involved in using the service. That being the case, we hope that the following observations will prove helpful as the Board completes this important step.

Part Two: The Proposed Regulation

- a. Interplay between Uniform Commercial Code Article 4A (UCC 4A) and the Electronic Funds Transfer Act (EFTA)

As the Board stated in the Notice, the expectation that FedNowsm will be used for both business and consumer transactions gives rise to the need to ensure that the appropriate rules governing both types of transactions, along with consumer and business protections, are addressed. We are in strong agreement with this goal and appreciate the effort that the Board has gone to in creating the proposed regulations. However, we fear that additional work might be necessary to accomplish the Board's objectives and provide the requisite clarity to all participants in the system. The proposed regulation poses at least three significant questions:

1. Is EFTA adequate to protect consumers in FedNow credit push transactions or are amendments to the statute or its regulations needed?
2. Is it beneficial to apply UCC 4A to aspects of transactions between parties who are not bargaining the terms?
3. Could the Board provide additional guidance to head off potential uncertainty among industry providers regarding when and how EFTA and UCC 4A apply to FedNowsm transactions?

First, there is the question about whether or not the EFTA itself is an adequate regulatory framework in terms of its scope of topics to provide sufficient protections for consumer transactions conducted through the FedNowsm service. Born out of a need to create consumer protections for then-nascent debit card transactions, which are debit-pull transactions, EFTA might not be well-designed to provide consumer protections for the credit-push transactions that will occur through the FedNowsm service. Consequently,

¹ See, e.g., U.S. PIRG Education Fund (June 2021). *Virtual Wallets, Real Complaints: How digital payment apps put consumers' cash at risk, An analysis of CFPB complaints.* https://uspirg.org/sites/pirg/files/reports/VirtualWallets/Virtualwallets_USP_V3.pdf.

² The Federal Reserve System (June 2020). *FraudClassifiersm Model.* <https://fedpaymentsimprovement.org/strategic-initiatives/payments-security/fraudclassifier-model/>

policymakers should consider through rules or guidance how to ensure appropriate consumer protections are in place for credit-push transactions that require payment finality and will result in immediate funds availability in FedNowsm.

Next, we take up the question of whether UCC 4A should be applied to aspects of transactions between parties who are not bargaining the terms. In contrast to wires, which are also processed through real-time gross settlement systems, and which are governed by UCC 4A, we note that while sophisticated consumers do conduct wire transfers in certain specific circumstances (e.g., to fund an escrow account) consumer use of the FedNowsm service is likely to be more widespread. This suggests a heightened need for a different approach. UCC 4A provides a set of rules that are intended to be bargained by the parties, so it is not clear whether or not it is appropriate to apply UCC4A to a broad array of circumstances, including consumer transactions, where the parties are not bargaining as to the terms.

In the Notice, the Board states that, “unlike the Fedwire Funds Service, which is designed to serve primarily as a large-value funds transfer system between institutional users, the FedNow Service is designed to also accommodate consumer use.” The implication of that fact – that FedNowsm is designed to accommodate consumer transactions – suggests that appropriate consumer protections should be included in the regulatory regime. For that reason, in the Notice the Board states that “in the event that a transfer of the FedNow Service meets the definition of ‘electronic funds transfer’ under the Electronic Funds Transfer Act (EFTA), proposed subpart C provides that UCC 4A would apply to the transfer but the EFTA would prevail to the extent of any inconsistency...” With respect to consumer protection, this may be less complete than it might appear, because EFTA does not provide a set of payment systems rules that will affect consumer users on issues such as authentication, security, and tracing and responses to red flags. The need to address these issues is heightened in a service such as FedNowsm wherein finality and irrevocability are expected to occur within seconds of the consumer sending a transaction. With respect to providers, it creates certain issues discussed below.

The Board is proposing an approach of relying upon UCC 4A as the primary body of law governing users of the service while also noting that in the event of an inconsistency between UCC 4A and EFTA, in the context of a consumer transaction, the EFTA would prevail “to the extent of the inconsistency.” This implies that while business transactions conducted using the service would be governed solely by UCC 4A, consumer transactions would potentially be governed by portions of EFTA and portions of UCC 4A that are not inconsistent with the EFTA. In fact, this appears to be the Board’s intent, as the Notice states that

“[b]y its terms, UCC Article 4A would not apply to a funds transfer any part of which is governed by the EFTA. Therefore, absent this proposed section in subpart C, a number of important legal aspects with respect to these consumer transfers over the FedNow Service could potentially lack clear and consistent rules.”

This approach presents a novel question, and one that could potentially lead to confusion and result in consumer losses that might undermine trust in the system – our second concern with respect to the EFTA/UCC 4A construct. Even in the absence of a conflict between UCC 4A and the EFTA, the UCC 4A rules were developed for large parties with equal bargaining power making large payments. They set forth a regime that may not be appropriate for, and may be unfavorable towards, consumers and some small businesses. It may not be appropriate to apply this older regime without section-by-section review and adjustment to a new context for which it was not designed.

If the Federal Reserve does apply both the EFTA and UCC 4A to consumer transactions, it is critical that the Federal Reserve identify with specificity which provisions of the EFTA are inconsistent with UCC 4A and explain how such inconsistencies should be resolved.

There are several examples of situations in which an inconsistency between the EFTA and UCC 4A may or may not exist. These examples are illustrative of the uncertainty and ambiguity that can arise under the proposed rule; however, they are not an exhaustive list.

- Misidentified Beneficiary. Under UCC 4A, where a payment order describes a beneficiary inconsistently by name and an identifying number, a bank can rely on the identifying number alone.³ In addition, as long as the bank provides the originator with notice that a payment order may be made based on the identifying number only, the originator is obliged to pay the order. The EFTA has no comparable provisions related to misdirected payments; however, the application of UCC 4A to a consumer transaction appears to be inconsistent with the consumer protection purpose of the EFTA.
- Unauthorized Payments. The EFTA provides that a consumer's bank is generally liable for unauthorized transfers.⁴ Under UCC 4A, the sending bank is also liable for an unauthorized transfer; however, a funds transfer is deemed "authorized" by the sending customer if the sending bank verifies the authenticity of the instruction in good faith based upon a commercially reasonable security procedure.⁵
- Period to Review Payment Orders. Provisions in the proposed regulations regarding the 60-day period to review payment orders are likely to create ambiguity for banks. The proposed rule specifies that for purposes of UCC 4A, a reasonable time to notify the Federal Reserve Bank of the relevant facts concerning an unauthorized or erroneously executed payment order is 60 days "after the sender receives notice that the payment order was accepted or that the sender's settlement account was debited with respect to the payment order." However, the EFTA gives consumers 60 days after a bank's transmittal of the first periodic statement showing the transaction to report unauthorized payments for the purposes of limiting their liability.⁶ (In the case of prepaid accounts, Regulation E allows a bank to alternatively allow a consumer to report an unauthorized transaction involving the prepaid account within 120 days from the date of the alleged error.) Since the periodic statement will often be provided after the sender receives notice that the payment order was accepted or the sender's settlement account was debited, the proposed rule will have the effect of creating a shorter period of time for depository institutions to notify a Federal Reserve Bank of unauthorized or erroneously executed payment orders than the time that consumers have to notify their bank of an unauthorized payment order for purposes of limiting their liability.

We also note that the private sector operator of the competitive real-time gross settlement (RTGS) service, The Clearing House, has published rules with a different, and perhaps more straightforward, approach to resolving this issue by avoiding the potential problems of applying rules developed for business transactions to consumer transactions. Its document entitled "Application of Key UCC 4A Concepts and Terms to the Real-Time Payment System" states as follows:

"[UCC 4A] applies to funds transfers as defined in 4A-104, except for funds transfers that are in any way governed by the Electronic Funds Transfer Act provisions that apply to electronic funds transfers (EFTs). (4A-102 and 4A-108). The Electronic Funds Transfer Act EFT provisions

³ UCC § 4A-207.

⁴ 12 C.F.R. § 1005.6.

⁵ UCC § 4A-202.

⁶ 12 C.F.R. § 1005.6(b)(3).

govern any transfer of funds initiated electronically that instructs a financial institution to debit or credit a consumer's account. (12 CFR 1005.3(b))”⁷

In this way, the private sector operator has bifurcated transactions conducted on its service into (1) those that are “in any way governed” by the EFTA, to which the EFTA, and only the EFTA, is applied and (2) those that are not in any way governed by the EFTA, to which UCC 4A, and only UCC 4A, is applied. That approach is consistent with current law and also avoids the difficult task of rethinking all of UCC 4A and whether and how particular provisions should apply to consumer transactions. Aligning with existing services on fundamental aspects such as the governing law can be an important enabler in achieving the Fed’s stated goals of “broad interoperability, end-to-end efficiency of payments and future innovation on top of the FedNow platform.”⁸

Should the Board maintain its proposed approach, we urge the Board to provide leadership in identifying the areas where the EFTA and UCC 4A are inconsistent, and thus where and how various aspects of UCC 4A would apply to consumer transactions. Taking this step would provide clarity in the marketplace, a key enabler for widespread adoption and usage of faster payments. It would ease the burden on payments providers of determining where the inconsistencies are and thus which rules apply. And it would mitigate the risk that different entities might decide those questions differently, and apply the rules differently to the same transactions, creating confusion, legal risk, and other consequences that are likely not the intended results of FedNowSM.

b. Immediacy

I. Fraud or errors

In the Notice, the Board states that upon a payment message being received it should be credited to the beneficiary “immediately” unless the “beneficiary’s bank requires additional time to determine whether to accept the payment order because it has reasonable cause to believe that the beneficiary is not *entitled* or *permitted* to receive the payment.” (emphasis added).

The ability of a receiving bank to perform various checks to monitor transaction trends for suspicious and out-of-pattern activity is an important aspect of promoting the safety and security of any payments system, and something that supports confidence in the system and thus expanding usage and adoption of payments services. That being the case, we believe it is important for the regulatory structure developed to support FedNowSM to enable financial institutions to develop systems to monitor activity in an attempt to prevent mistakes and fraud in the system. We believe this would require that financial institutions be permitted to monitor and decline to accept payments for reasons going beyond having “reasonable cause to believe that the beneficiary is not entitled or permitted to receive the payment.” For that reason, we suggest that the Board consider broadening the section describing delay in acceptance or, at the very least, broadly defining the word “entitled” to provide necessary flexibility and clarity to the marketplace regarding the steps a financial institution may take prior to accepting a payment and making final funds available to a recipient. In addition to a broader standard, the provision of examples from the Board in the commentary of situations that would be permissible and impermissible, including examples involving fraud or errors, would likely provide additional clarity, and is therefore recommended.

⁷ The Clearing House (October 2017). *Application of Key UCC 4A Concepts and Terms to the Real-Time Payment System*. . <https://www.theclearinghouse.org/-/media/new/tch/documents/payment-systems/tch-rtp-ucc-4a-schedule-103017.pdf>

⁸ The Federal Reserve (March 2021). *Federal Reserve announces ISO[®] 20022 specifications for initial launch of its FedNowSM Service for instant payments*. <https://www.frbservices.org/news/press-releases/033121-federal-reserve-announces-iso-20022-specifications-initial-launch-fednow>

More preferably, adding language that creates the ability of a financial institution to hold funds when there is a reason to believe the payment could be fraudulent or might have been made in error could incentivize the development of tools intended to detect and prevent fraudulent activity and mistakes. Over time the development and refinement of such tools would likely support the Board’s desire to promote public trust in the payments and financial systems of the United States. It is important that any amendments to the language should provide as much clarity and specificity as possible around what is and is not considered to be an exception while balancing the desire and expectation that the vast majority of transactions will be processed – accepted or rejected – immediately.

II. Definition of “immediate”

Additionally, the Board specifically asked whether or not the term “immediate” should be defined in the regulation. A quick review of comparable systems and criteria, both domestic and international, reveals that there is not a consistent approach to this question upon which the Board can rely.

- I. The Clearing House’s RTGS system, the RTP network, states in its FAQs that recipients receive the payment “within seconds” of initiation by the sender.⁹ The RTP Network rules state that “A Receiving Participant that responds with an ‘accept’ message must make funds from the RTP Payment available to the Receiver...upon receipt of a message from the RTP system acknowledging receipt of the Receiving Participants ‘accept’ message.”¹⁰
- II. In 2016, the Faster Payments Task Force (FPTF) published faster payments effectiveness criteria, including a criterion identified as “Fast availability of Good Funds to the Payee.” That criterion states that a solution that enables availability of good funds “within 1 minute” is considered to be “very effective.” However, the FPTF noted that “[t]his criterion is measured from the completion of payment initiation...to the point when funds can be withdrawn or transferred by the Payee.”¹¹
- III. The UK Faster Payments system FAQs state that, “provided the sending and receiving bank...are Direct Participants of Faster Payments, payments are usually available almost immediately, although they can sometimes take up to two hours.... As a minimum...any payments made by mobile, internet or phone banking...must arrive by the end of the following business day.”¹²
- IV. The Bank for International Settlements’ Committee on Payments and Infrastructure defines a “Fast Payment” as “a payment in which. the transmission of the payment message and the availability of “final” funds to the payee occur in real time or near-real time on as near to a 24-hour and seven-day (24/7) basis as possible.”¹³
- V. The New Payments Platform in Australia states that it offers “Real-time clearing and settlement,” and that it “operates 24 hours a day, 365 days a year.”¹⁴

⁹ The Clearing House. *The RTP Network: For All Financial Institutions, Frequently Asked Questions*. <https://www.theclearinghouse.org/payment-systems/rtp/institution>

¹⁰ The Clearing House (June 2021). *RTP System Operating Rules*. https://www.theclearinghouse.org/-/media/new/tch/documents/payment-systems/rtp_operating_rules_effective_06-15-2021.pdf

¹¹ Faster Payments Task Force (January 2016). *Faster Payments Effectiveness Criteria*. <https://fedpaymentsimprovement.org/wp-content/uploads/fptf-payment-criteria.pdf>

¹² Pay.uk. *Faster Payments FAQs*. <https://www.fasterpayments.org.uk/faqs>

¹³ Bank for International Settlements Committee on Payments and Market Infrastructures (November 2016). *Fast payments – Enhancing the speed and availability of retail payments*. <https://www.bis.org/cpmi/publ/d154.pdf>

¹⁴ NPP Australia Limited (2021). <https://nppa.com.au/>

While there does not appear to be a standard approach among existing solutions and industry guidance, it is clear that there is a general expectation for final, irrevocable funds to be credited to the beneficiary within a matter of seconds, not minutes or hours. That said, with the wide variety of use cases envisioned for the service, the establishment of a definition of “immediate” in the regulations could serve to inadvertently stifle the adoption and usage of the service for certain use cases. Thus, it is possible that establishing a definition would be best done via subsequent operating circulars after gaining experience during the pilot process and post launch with live transactions. However, in establishing any definitions of “immediate,” given the expectation that “immediate” will ultimately be a matter of seconds (or even sub-seconds), the Board should carefully consider the concerns raised above regarding receiving financial institutions’ need to delay provision of final funds in limited circumstances to investigate red flags.

c. Operating Circulars

The Notice states that the proposed regulation “grants the Reserve Banks authority to issue an operating circular for the FedNow Service, which would detail more specific terms and conditions governing the FedNow Service consistent with the proposed subpart.” We believe that the development of a process for creating and refining the rules that govern the service is a crucial, and appropriate step for the Board to take, once the basic rules or principles on key topics have been defined through regulation. Responding to market conditions and spurring adoption of faster payments services will require that the Fed have the ability to change aspects of the service swiftly.

As the Board considers how best to approach the introduction and ongoing operation and governance of the FedNowsm service, we believe the Board should adhere to the same spirit of transparency and inclusiveness that were central to the Federal Reserve’s Faster Payments Task Force and to the Governance Framework Formation Team, which was convened as part of the Federal Reserve’s payments improvement project.

In developing a process for the creation of operating circulars to govern the FedNowsm service, we urge the Board to consider how best to ensure that the voices of all stakeholder segments are positioned to provide structured insights to the relevant Reserve Banks while also ensuring coordination across other providers of faster payments services, including where appropriate advance notice and the opportunity for public comment.

Part Three: Conclusion

The payments ecosystem in the United States is in a state of flux and advancement unlike any we have seen in decades – perhaps ever. Network providers, financial institutions, users of payments services, and those who support all of those stakeholders are engaging in an unprecedented collaborative effort to help the United States reach our faster payments future. We appreciate the opportunity to provide the above thoughts and insights from the broad perspective of our signers, and we hope the Board derives value from the observations we have provided.

Sincerely,

Michael Bilski, Chief Executive Officer, North American Banking Company
John Breyault, Vice President, Public Policy, Telecommunications, and Fraud, National Consumers League
Kevin Christensen, Senior Vice, Market Intelligence & Data Analytics, SHAZAM
John Drechny, CEO, Merchant Advisory Group
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Charles Harkness, Senior Vice President, Corporate One Federal Credit Union
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Adam Rust, Senior Policy Advisor, National Community Reinvestment Coalition
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