

# Consumer Finance Monitor (Season 6, Episode 37): What is FedNow and its Role in the U.S. Payments System?

Speakers: Alan Kaplinsky, Ron Vaske, and Dan Awrey

Alan Kaplinsky:

Welcome to the award-winning Consumer Finance Monitor podcast, where we explore important new developments in the world of consumer financial services and what they mean for your business, your customers, and the industry. This is a weekly show brought to you by the Consumer Financial Services Group at the Ballard Spahr law firm. I'm your host, Alan Kaplinsky, former practice group leader for 25 years, and now senior counsel of the Consumer Financial Services Group at Ballard Spahr. I'll be moderating today's program. For those of you who want even more information, don't forget about our blog, which is also called Consumer Finance Monitor. We've hosted the blog since 2011, so there is a lot of relevant industry content there, including content on the topics that we're going to be discussing today. We also regularly host webinars on subjects of interest to those in the industry. To subscribe to our blog or to get on the list for our webinars, please visit us at [ballardspahr.com](http://ballardspahr.com).

And if you like our podcast, please let us know about it. Please leave us a review on Apple Podcasts, Google, Spotify, or wherever you access your podcasts. Also, please let us know if you have any ideas for other topics that we should consider covering or speakers that we should consider as guests on our show. A little bit of background about today's show, and I'm going to in just a moment introduce our two presenters today. In December of last year, I was looking for somebody that was an expert in the area of so-called Federal Reserve payment system, which is known by the name FedNow. I came across Professor Dan Awrey at Cornell Law School. Dan and I talked about FedNow, and of course, it had not yet been launched at that point. Instead, we had a really interesting conversation that got released in January, it was actually on January 5 of this year.

Let me describe to our listeners what we talked about then. Then we will, as I said, we're going to be really drilling down today on the new FedNow system. I want to know in particular whether any of Dan's opinions have changed as a result of the launch of the FedNow system. We set on our blog on January 5 after discussing the core features of the US payment systems. We look at how those features have impacted the experience of US business and consumers, and why Professor Awrey believes they've resulted in a payment system that is worse, more expensive and slower than payment systems in other large developed countries. We also explored the types of changes that are needed to improve the US payment system, including how the Federal Reserve system can take a more proactive approach to spurring the development of new payment technologies, assess the likely impact of the FedNow real-time settlement service on the payment systems, and consider the overall prospects for improvement to the payment systems.

Well, it was a very, very interesting conversation I had with Dan. It was to some extent, a bit discouraging to learn how far behind the United States is when it comes to providing an efficient, effective system that works for industry and consumers. Neither of us knew at the time exactly what the final contours would be at the FedNow system. We were projecting a little bit into the future, and based on the knowledge that Dan had, he was not very optimistic. Let me now give Dan a real formal introduction. He's a professor of law at Cornell, as I mentioned. His teaching and research interests reside in the area of financial regulation and more specifically, the regulation of banks, investment funds, derivatives markets, payment systems, and financial market infrastructure.

He has undertaken research and provided advice at the request of organizations, including the Bank for International Settlements, the US Treasury Department, the Federal Reserve Board, the President's Working Group on Financial Markets, HM Treasury, UK Financial Conduct Authority, the Commonwealth Secretariat, and European Securities and Markets Authority. His research has been featured in publications including Yale Law Journal, the New York University Law Review, Georgetown Law Journal, Cornell Law Review, of course, Harvard Business Law Review and the Journal of Comparative Economics. He's a co-author of one of the leading textbooks on financial regulation, which is called the Principles of Financial Regulation published by Oxford University Press. He is also a founding co-managing editor of the Journal of Financial Regulation. Dan, welcome back to our show.

Dan Awrey:

Thank you, Alan. It's really great to be back. Thanks for having me.

Alan Kaplinsky:

Terrific. Also, joining us today, as he did back in December on your first appearance on our show is my colleague Ron Vaske. Ron is in the consumer financial services group at our firm. He co-leads the firm's FinTech and payments industry team. He's helped clients develop innovative products and services for more than 25 years, including payment and deposit products. His clients include banks, FinTech companies, payment facilitators, and companies that provide banking as a service. Ron, a very warm welcome to you as well.

Ron Vaske:

Thank you, Alan.

Alan Kaplinsky:

Okay, I have a lot of questions for Dan this morning, mostly based on FedNow, but also want to find out whether the things that he said back in December of last year still hold true, whether anything has changed. Ron's role is going to be simply commenting on various things that Dan says, where he has something that he would like to add. Without further ado let's jump right into it. Dan, the Fed launched FedNow several weeks ago. I guess everybody's had an opportunity to read about it. Maybe you could tell our listeners first of all, what is exactly FedNow and also what is FedNow?

Dan Awrey:

Sure. FedNow is a messaging system. When you think of electronic payments, there's two elements to them. One is somebody has to tell somebody else to make a payment and then that person has to ensure that whoever the payor is has sufficient money in their account or however they store electronic value. Once that's confirmed, then a payment instruction is issued. That payment instruction then goes towards something called settlement, which is the actual exchange of value within that system. FedNow is entirely the first part of this story. It is using the internet, finally. Welcome to the internet age, Federal Reserve, to make payments. It's using application programming interfaces to initiate a payment to ping the payor institution to say, "Does this person have that money in their account?" If yes, it then proceeds to make an automated instant payment using the Fed's existing architecture for settling payments, the settlement accounts that banks have with the Fed.

Now that leads into what FedNow is not. There's lots of hype that FedNow is some path to a central bank digital currency. It does absolutely nothing to change the way that banks settle payments between each other, both via existing systems like Fedwire and RTP. It uses the Fed's settlement balances as the final form of settlement and nothing really changes there. All that's changing is the messages that are sent and the technology that's used to send those messages.

Another thing that FedNow is not, is a revolution in how consumers are going to make payments in the United States, at least not as presently devised. One thing, as we talked about in the last episode, we already have a real-time payment system in the United States, the privately run RTP, real-time payment system that has been up and running now for several years and counts as its customers, all the major banks and other financial market infrastructure. At the same time, there's a missing piece of FedNow in my view that really undermines the extent to which it's going to lead to consumer welfare gains, which is the fact that unlike in other countries where faster payments technologically were accompanied by a legal mandate to give customers faster payments, no such mandate exists in the United States.

If I go on to my bank right now and I look for the button that enables me to make a FedNow faster payment, I'm not going to find it and I'm not going to find it because it's not there. That's an important thing to understand as well, that this is a project in pieces and at the moment the pieces that are in place are very unlikely to live up to the hype in terms of transforming the way that consumers make payments.

Alan Kaplinsky:

You said back in December of last year when we did our last interview on the subject that you didn't think FedNow was going to change a heck of a lot and you mentioned RTP or real-time payments that already exists, that the larger banks are going to be using, and I think you said, "There's no reason for them to change because it's not much different than RTP, and why go to FedNow when you already have a system that's been up and running for many years." I think you also said the success of the FedNow system really depends upon the extent to which they can make inroads into the smaller community banks that aren't presently using RTP. I assume because they think it's too expensive, though maybe there are other reasons as well. Does that still hold true, Dan? Do you want to amplify on that?

Dan Awrey:

It does, and I can talk about that a little more, but I'd like to highlight two differences in the design of FedNow, really between when we recorded our initial podcast in December and today. The first is that I still held out a modicum of hope at the time that the technology underlying FedNow would be interoperable with RTP. That would expand the scope of the network that members of FedNow were making payments in and in theory could provide at least some benefits to institutions that subscribed to these services that could then be passed on to customers. In the end FedNow is not interoperable with RTP and it doesn't seem like there's a plan to make it interoperable with RTP, which is unfortunate. The second thing that happened was that we got the final pricing schedule for FedNow and drum roll, it's actually identical in every way to the pricing schedule for RTP.

If I'm a small bank hoping beyond hope that my Federal Reserve Board would intervene and make a more economical, at least on a unit cost basis or a transaction processing basis, my core payment infrastructure. I was probably sadly disappointed, although maybe not that surprised to see that at least in terms of the variable cost of using the service, that it is identical to the existing offering out there. It's ultimately not the variable cost that give me so much reason for gloom and doom, it's the fixed upfront costs that small banks have to incur. I said before that FedNow brings the Fed into the internet world using an application programming interface, an API to communicate between banks and to really automate large parts of the clearing and settlement process and put the real time into payments.

Well, a large portion of American banks are not in the internet world yet either, and these are precisely the banks that might benefit the most from this type of technological upgrade. But that technological upgrade is not cheap and generally has to be outsourced to third-party providers who have been very active in promoting FedNow as a future source of business for them. But in terms of the incentives of many banks to actually make the infrastructure investments necessary to bring their tech up to standard, at least some of them, and remember there are several thousand of these small banks. My guess is that several thousand of that several thousand are going to look at the economics of upgrading their tech platform just to make faster payments that ultimately are designed to benefit their customers as not being good business.

That's ultimately the source of a lot of my concern here. I say this as a lover of community banks, as a customer of a community bank, that I'm pretty sure will never sign up to FedNow. These are precisely the institutions that could really benefit from this service, but the service just falls short in terms of the extent to which the Fed needs to be the ones developing the infrastructure in cooperation with private sector technology providers. They've just stopped short of that.

Alan Kaplinsky:

What do you take as the reason why... These observations that you're making, I assume there're smart people that were working at the Fed and that were involved in the design and the rollout of FedNow. What were they missing? Everything you've said makes a lot of sense to me, but why do these people just not get it, I guess?

Dan Awrey:

Sure. The first thing to say is my disappointment with FedNow shouldn't be taken as a criticism of the Fed per se as much as it was I welcome their belated entry into payment infrastructure development and just thought they should go far. In that respect, there's always going to be a diversity of views around how far is far enough. Certainly as somebody who looks at these things from a comparative perspective, who's worked on and studied the payment systems in a variety of other highly

developed, but also many developing countries where the real innovation, quite frankly, is happening in payments and scanning that horizon, I'm just able to see what's out there. I often joke that as a Canadian, I've moved to the United States to make it seem like I know what the future is, and that's because the United States is stuck in the past.

With my absolutely zero policy influence and copious amounts of time to research the cutting edge around the world, I'm probably going to be more aggressive in my approach to what the Fed do than perhaps the Fed itself. Now, there are a couple of other explanations that are worth mentioning here. One is that there are complications under the Monetary Control Act of 1980, which depending on your interpretation, may limit the ability of the Fed to offer competing services in the payment space without offering compensation to those that it's competing with. Certainly this is a concern that's been raised by the folks in the Bank Policy Institute, for example, who suggest that really if the Fed is going to get into the game, the Monetary Control Act, the game of payments, the Monetary Control Act puts constraints on their ability to effectively compete with private sector payment providers.

While I don't necessarily agree with the BPI's interpretation of the Monetary Control Act here, it's interesting to note that the fee schedule ends up being identical. In that respect, at least inferentially suggests that folks of the board do take this interpretation of the Monetary Control Act seriously and don't want to run afoul of it. That then helps to explain why not only the pricing schedule, but why the Fed didn't invest more heavily in rolling out a Cadillac of public sector payment infrastructure. It is because that the Cadillac might outcompete existing providers and therefore lead to potentially thorny issues around the monetary control.

Alan Kaplinsky:

What we really need to, seems to me somebody needs to sponsor some legislation to modify the Monetary Control Act provision, but I assume with the dysfunctional Congress that unfortunately we're stuck with, that ain't going to happen.

Dan Awrey:

Yeah, I suppose that person would be me, and not to advance this too much, but in the next few weeks I hope to be coming out with my own model legislation for a federal payments policy initiative that includes a new governance framework for the payment system of the variety that are used quite commonly in other jurisdictions where we are taking the inputs and interests of a variety of different actors in the system, so big banks, little banks, consumers, the federal governments, technology providers, and attempting to use that to come up with a long-term strategy for investments and upgrades in US payment infrastructure. As part of that you do have to, if you believe in this interpretation of the Monetary Control Act, need to amend it in order to clarify that this is not in violation of and paradoxically the Monetary Control Act, at least this portion of it was largely created in order to engender greater competition in the US payment system.

It just wasn't designed to do it where the public sector was competing with the private sector under certain circumstances. In many ways, what I'm ultimately going to be proposing is very much in that spirit where what we need is more competition on the technology side of payments and not less. And what we need is the federal government to bring its ability to convene and coordinate large scale projects to developing and encouraging the private sector development of that infrastructure over time. I agree completely that somebody needs to put legislation out there. It's unfortunate that it has to be me because despite the lengthy bio that you ran off at the start, my history of people actually listening to me when it comes to payment policy in the United States is not particularly encouraging.

Alan Kaplinsky:

I was always the first, right?

Dan Awrey:

That's right. I'm the broken clock that hopefully is right, at least once a day.

Alan Kaplinsky:

I assume part of the problem that you will run into in terms of opposition will be from the large banks that are behind RTP. They're, I assume perfectly content with the system that they have now and don't want the competition.

Dan Awrey:

Yeah, I think that's right. I think it's a good-natured objection in many ways. RTP itself was a big step forward for the US payment system, and it's notable that it was entirely a private sector initiative. It was, however, a private sector initiative amongst a relatively concentrated set of very large banks and in the United States with its very diverse ecosystem of large banks, small banks, and then non-bank payment systems, those other two sets of actors have largely been left out. That's the part that I think needs some sort of redress basically. I'm all for celebrating the success of RTP, but I also think that things like access to the payment system, technological infrastructure upgrades, and then ultimately where the benefits are consumers are questions that aren't necessarily going to be best addressed by just having RTP in the marketplace.

Alan Kaplinsky:

Right. Let's take a look back at the origins of FedNow. First of all, how many years was it from the time the idea developed until it finally got launched?

Dan Awrey:

Sure. There's two answers to that question and you can tell a lot from somebody by whether they say that this is now a eight-year project or a four-year project. The eight-year project people normally bear the scars of something called the Faster Payments Task Force, which was launched by the Fed in 2015 to explore the possibility of developing a faster payment system. This was a huge undertaking involving over 300 different direct participants who ultimately produced a final report in 2017. As is often the case when you get 300 people with divergent views and interest into a room, the level of agreement was really on very broad strokes. Yes, faster payments are good and we should get some of those, but in terms of who should be responsible for delivering it and how it should be delivered, there wasn't really a lot of consensus.

In this eight year view, the seed, the kernel of the idea of FedNow was really launched before the name FedNow was ever uttered back in this Faster Payments Task Force. What's interesting is what happened right at the end of the Faster Payment Task force. Really, as it was delivering its final report, we get the introduction of RTP. Effectively a group of large banks representing the vast bulk of payment volumes and deposits in the United States saying, "You know what? We can do this, but we want to do it on our terms. We have enormous economies of scale, we have enormous technological capacity, and we have enormous balance sheets to absorb some of the costs associated with this type of project." And they went out and did it and launched RTP more or less around the time that the final report of the Fast Payments Task Force was issued.

We then get two years where it's unclear whether we're really going to get something out of the Federal Reserve as its response to the emergence of RTP. And for the four-year [inaudible], it's only in 2019 that we get the name FedNow and we get this idea that the Federal Reserve is actually going to at some point issue its own faster payment platform that we get. The interesting four years between 2019 and now, we get admittedly a shiny website out of the Fed that talks in broad strokes about what FedNow is supposed to be and the people that it's supposed to benefit. But we do not have a lot of clarity about the technical design of FedNow. For folks like me who are looking at both the technological design but also legal mandates embedded within these systems, we don't get a ton of information.

We get drips and drabs. We get some aspirational statements, some of which turn out to be true and baked into the design of FedNow. Some of them that aren't. I say this not to simply say that the process was opaque, but this is one of the things that I think needs to change about the governance of payments in the United States. Some folks in a room somewhere come up with a design on the basis of their own set of incentives and own technological outlook. Then several years later we get a finished product. There's no really structured public input about what the features of FedNow should look like. There is no public facing, public research on the potential benefits of FedNow under different types of design models. We basically get a black box between 2019 and 2023, at which point we get the system that now we call FedNow, but really without a lot of insight into why this FedNow and not another FedNow, a better FedNow.

Alan Kaplinsky:

They didn't at any point while they were developing it, seek input from experts like yourself? They just decided they would go it alone, that they knew what they wanted to accomplish and no need to seek any advice from others.

Dan Awrey:

Well, let me clarify. What they didn't do was have a public process where people that they didn't choose could provide their advice and feedback. They consulted quite a bit with technology vendors who are very familiar with really the, I don't want to say it's basic technology because as somebody with a long stalled background in software who's now currently trying to get back into programming, nothing is simple about this. But the task, the project was a relatively straightforward technology task for these vendors who then are doing this every day. Really, this is their bread and butter. They also, my understanding is, met with groups of community banks. They met with non-bank technology providers who might want to use FedNow to build additional products and services on top of it. But we don't entirely know who they are. Some of it's disclosed on their website.

We don't know what the discussions were or how they were framed, what type of questions were asked. We didn't see any of the internal research product of the Fed about why we should do this and how we should design it. I think it's something so basic as infrastructure, right? If we're going to build a new highway through a city, chances are we're going to get, although nobody will go to the meetings, but there's going to be public notice of this. There's going to be an opportunity to comment on the plans. There's going to be the opportunity to push back. And if that pushback gets serious enough, to bring legal claims against the government authority for violating property rights, creating ghettoized neighborhoods or whatever it is. Payments are roads, we travel on them every day of our lives. In that respect, it is odd that for something so fundamental to our economic lives that the process by which those roads are designed are done in relative secrecy and without clear public inputs about how they should be built and how the services should be delivered.

Alan Kaplinsky:

Right. I know you're not particularly involved in the consumers' movement, but what have you heard from them? How have they replied so far or responded to the rollout of FedNow? Do they view this as a great thing for consumers? Do they see it as making P2P payments quicker and less subject to fraud, I guess, is the way to put it? How are they looking at it?

Dan Awrey:

I think it's a mix, and I'll start with fraud because it's always an important question around real-time payments. One of the reasons why I have trepidation about the Fed designing this is that the Fed is not a technology vendor. And if you've ever worked with the federal government at all, and this is no disrespect to them, it's a huge organization, getting anything done technologically is hard. It's just administratively procedurally difficult. What that means is that in general, you don't get a lot of technological innovation out of the federal government. The reason why PayPal is PayPal is that its fraud algorithm when it was launched was the best in the business. It had to be because it was delivering peer-to-peer payments in real time. Exactly what FedNow is now doing.

I don't have enough information about the FedNow algorithm as such there is one to really answer the question of whether it's going to be good, but consumer groups are rightly focused on the issue of whether it will successfully detect fraud. Now, cutting against that is the fact that one of the good parts of the United States payment system is that a lot of fraud actually falls on the financial institution. The cost of fraud fall on financial institutions, not the consumers. I think this probably, and perhaps rightly means that it hasn't been a huge issue for consumer groups as far as I can tell, but it's been there.

Alan Kaplinsky:

Except in the area, maybe Ron, this is where you could jump in, there's been a tremendous amount of controversy and uncertainty about what should be done in the situation where a consumer is scammed, doesn't realize it, of course, and then actually authorizes a P2P payment and the banking industry, that's the one area that doesn't seem to be covered under the Electronic Fund Transfer Act, the Reg E and the head of the CFPB has been doing a lot of jawboning telling banks they ought to cover that loss. And to some extent, the banks have agreed, but to some extent they've pushed back on it because it's

a very big number. I think a lot of the consumerists are hoping that that problem is going to get solved by FedNow. Ron, do you want to elaborate on anything I said?

Ron Vaske:

I guess I would say I think the consumer bureau probably thinks it is covered by Reg E and those would be unauthorized transfers. I think that's where industry is going, but there is resistance to it, and there's definitely a good argument that it's not and that been the traditional argument. That's where we've been up until the last couple of years.

Alan Kaplinsky:

P2P payments, yeah, the consumers are happy about one piece of the fraud that is where somebody hijacks somebody's PayPal account or Zelle or any one of the P2P providers and the consumer isn't even aware, that does not press the button to authorize the transaction, but where the consumer presses the button, the law's not so clear there.

Dan Awrey:

Yeah, and certainly the big headline thing I think about any sort of real time payments rail is that it does shift the burden onto the fraud algorithm and out of the other processes that any delay would enable the financial institutions to undertake, to detect fraud. The faster you go, the higher the cost of fraud or a higher likelihood that fraud is going to impact somebody, whether it's the customer or the financial institution, simply because you've not got the same redundancies in place necessarily. Now, that's not necessarily true. I think that PayPal's algorithm, for example, still does a fantastic job and those transfers are typically taking place in real time. Zelle, conversely has had trouble with its fraud algorithm.

It hasn't been able to have the same standard in terms of being able to detect and unwind fraudulent transactions before they take place in effect. But it does put the emphasis then on technology being the key to the success of fraud detection and prevention. I think there's a conversation to be had about who makes the decisions about what technology we're using and whether an organization like the Fed, even with the benefit of whoever it consulted from a technology perspective, is really most likely to be the ones that come up with the most effective fraud prevention in real time payments.

Alan Kaplinsky:

Yeah. I think, as I recall our interview back in December of last year, you did not think that FedNow would be successful. Have you changed that view? Do you think it's going to wither away over some period of time? It's not really going to gain any traction.

Dan Awrey:

The first thing is that I hope I'm wrong. I really honestly hope I'm wrong. I hope that community banks are most likely to use this service, do usher themselves into the internet age and sign up for it. I then do hope that they create clear and visible options for customers who want to use faster payments to use faster payments. But I don't think it's going to happen, and I don't think it's going to happen for the reasons that we talked about before. I think that the technology spend is just simply too high for many small banks. I think the absence of a legal mandate means that it's unlikely that they're going to offer their customers this service. I encourage your listeners to go and ask your bank... Look at the list of FedNow, 50 or so institutions that have signed up to FedNow to date, and if your bank is on them, call them and ask them or browse the website and see if you can find where it gives you the customer the option to use a faster payment.

At least what I'm seeing so far, the answer's probably going to be maybe not. And in many cases, these institutions have signed up to faster payments to the FedNow system as receive-only participants. That means they can receive faster payments, but they can't make faster payments. That tells you, I think, something about the incentives buried within this system is that everybody wants to get paid faster. That's great. Nobody wants to make payments faster unless there's a clear business case for doing so, and even the existence of the option to just have a receive-only FedNow participation suggests that these incentives are really quite weak.

Alan Kaplinsky:

I'm wondering, Ron, we do a lot of work particularly in the Midwest for community banks. Are you aware of any of our community bank clients contacting us to talk about the pros and cons of getting involved?

Ron Vaske:

I'm not aware of any. I've not seen any that are involved in FedNow and looking at the list, I don't see any that we work with that are on FedNow. It seems to me, and maybe this is a question, isn't the solution that the core processors... Most community banks aren't running their own system. They're on Jack Henry or Fiserv or something like that. Isn't that where the technology has to be to enable it?

Dan Awrey:

That's right, but that's precisely where the fixed cost comes in for small banks, right? It's hiring Jack Henry or Fiserv to come in and change their tech platforms, right? A lot of them are operating on pre 2001, so pre API tech course, and they're doing so not because they think it's good, but because Fiserv or Jack Henry came in and gave them a quote for how much it's going to cost to move into the 21st century. For a lot of these banks, it's that exact cost that is the barrier to becoming a FedNow participant. You're absolutely right. This is not a situation. Very few banks in the United States are make versus buy sort of optional, right? Almost everybody, you got to buy it, you can't make it. You don't have the technology infrastructure or expertise in-house to do this. There's Jack Henry, FIS, Fiserv, and a couple of others who do do this.

They definitely have the expertise to be able to give you an off-the-rack tech stack, but then that's going to be really costly and all it's really going to do, it's not going to differentiate you from J.P. Morgan or Citigroup or the big regionals or anything like that. It's going to give you a version of their platforms. It's not even like you're going to become more competitive and be able to say to your customers, "Gosh, our payments are [inaudible] than J.P. Morgan." It's going to give you a rough approximation for all of that money of services that other larger banks are already providing. This only makes the incentive effects even lower, right? If I'm a CFO trying to justify this investment, it's very difficult for me to figure out exactly why I would want to do it. Other than that, over the longer term, I might be dead, right?

Community banking in the United States might die because the technology environment since the 1980s has changed so fundamentally that maybe community banks can't survive. And if that's the case, there's two options. This is going well beyond FedNow, but there are two options. One is to accept that and to understand that the fragmentation of the US banking system is a historical and jurisdictional anachronism. We have way more banks in the United States per capita, per GDP, per everything than any other country par Germany, in effect.

The second thing we can do is say, "Look, we want community banks. We like community banks, but man does [inaudible] the economics of community banking present challenges in a world where technology is so important. There's one of the places where I think the Fed and the federal government can be more proactive if they chose to actually recognize the benefits that community banks serve, but then to loosen the challenges or to relax some of the challenges that they face with this infrastructure. Historically, the classic congressional move is, well, lower capital requirements, less bank supervision. And instead of that, I would pivot towards better infrastructure provision and development, subsidized infrastructure provision and development for things like payments, for things like technology.

Alan Kaplinsky:

Right. You mentioned a little bit earlier that you're working on drafting some federal legislation that if it became law would be at least a starting point for bringing our payment systems into the 21st century, I guess. I assume that nothing's going to happen overnight, even if you were successful in getting a bill through, that's going to be a long slog, certainly not going to happen this year. You can't predict the future there. Is that the only hope that without that things can't be done to really bring us up to the state of affairs in countries like Brazil, which I think you mentioned on our last show as a much more sophisticated system than we have. Is that the only hope, legislation?



Dan Awrey:

I honestly struggle with that question. It's a great, great question. The Brazil example is an interesting one because the central bank decided to do it. They did it, and two years later, payments are fundamentally different in Brazil, right? They spent, rumors suggest, around five million bucks, a pittance really, to develop their ATI. They use some political heft to say, "You, banks, you're signing up to this. We gave you a license, and part of the conditions of that license are that you sign up to this new system." And that was it. And then Pix skyrockets in popularity. You go from a very, very expensive cash-based retail economy to an increasingly electronic one and using a technology that probably doesn't work for the United States, which is not itself at the cutting edge.

The Pix system in Brazil is largely QR code based, which is relatively easy to implement, and so long as you've got a smartphone can become quite ubiquitous in terms of piggybacking on the existing in effect mobile phone infrastructure of your country to build a payment system. Now, other countries have done that as well. Mobile banking in Kenya and throughout much of Sub-Saharan Africa is a similar story. A lot of it through Southeast Asia as well. On the one hand I want to be optimistic and say, "Do you know what? The technology is there."

Brazil is actually slightly ahead of the United States in terms of its legal framework. It had the political will, so that mattered less because it was able to get the legislation and get banks on board. Where this becomes depressing, I think, is the muck of federal payment policymaking in the United States in particular. Where it doesn't appear that there's a huge political will to move forward with some of the more muscular solutions to this problem. There's no mandate in FedNow that you have to actually offer your customers faster payments, which suggests to me that there's also not going to be a lot of appetite out of treasury, out of the Fed to say to the banks, "Look, this is happening, and you can either do the thing that you say you do so well, compete, or you can step aside. We don't care which one, but you're not going to inhibit us from this." That's a huge ask. The banks of the United States are incredibly economically important. They're also incredibly embedded in the Washington policy apparatus at various levels.

The solution is right in front of us, but I think this is more of the Battle of the Somme than it is blitzkrieg when it comes to trying to get this done and that every inch of ground is something that's going to have to be fought for. I think you're probably right, that this is something that may take a very long time and there's no guarantee of success whatsoever. We are a whole generation behind in the United States. There's a reason for that, and certainly I don't take that lightly. It helps that I'm a nobody and an academic, that I can put out legislation that I hope somebody at some point will be like, "Oh, that's a useful starting point. I'm going to redline 90% of it, but maybe that's section six over there where I talk about open access requirements and section nine where I talk about the need for interoperability and coordinated tech infrastructure upgrades. Maybe that gets picked up someday."

Alan Kaplinsky:

Now, you talked a little bit earlier, in fact, right at the outset of our discussion about what FedNow is not, and you made it clear it's not digital currency, but there's been a lot of talk about digital currency. I'm wondering whether the development of a digital currency, which of course, would require legislation as well, that could displace the need for a faster payment system. If we had a digital currency, I would think the way it would work is people would be able on their computer to essentially transfer value in real time.

Dan Awrey:

Yeah, there's different models of ACBDC. That's what we might think of as the retail model where either we all have Fed accounts in effect and we're all transacting with each other in Federal Reserve balances. Or a system where rather than having a balance sheet, we have tokens that we can hand out like electronic cash, right? That model is one that... There's a lot of headwinds to it, especially in the United States. Having the government with theoretical access to your payment information, what you're buying and selling and things like that, is something that will concern a lot of people and already has concerned a lot of people. At the same time, if I tokenize all that money, I make it anonymous. Well, there I start to worry about some of the problems that have recently been in the news around things like money laundering, terrorist financing, how the US dollar is being used in effect.

If you take all those issues as being really redline issues for a lot of people in the United States, and this is where it becomes important that it requires legislation. The idea that Congress is going to be able to navigate those very serious misgivings about their relationship with the government seems to me to suggest that this is a no-go option. The other option is to say, "Okay, look, we've had a CBDC all along. It's called a Federal Reserve balance. It's just that we don't do day-to-day payments in it. We let banks transact with that money. They pay each other using Federal Reserve balances. And in fact, what we could do is open up that system a little bit to allow non-bank providers to also settle transactions between other eligible institutions within that network." And that's largely with the versions of the stablecoin bill were originally designed to do.

The one that's been debated back and forth at the House Financial Services Committee for the past year or so, and that's what my proposal would be or will be... I've been writing on this, I guess, for a very long time now, is to say, "Look, I want a layer between my federal government and me and my money. And I want that layer for two reasons. One, maybe I don't want the federal government to know, or at least even the prospect of the federal government knowing everything I'm spending my money on. Two, I want this layer to actually be good at technology and good at customer service and responsive to my needs as a customer because they're a private business." That's what banks are. That's what PayPal is. That's what a lot of the institutions that populate this space are. What I want them to be able to do is compete with each other on equal terms so that we start to get the type of environment where they compete leading to consumer facing innovations, both in terms of the speed and quality of service, but also the high cost of service.

As we talked about the last time we spoke, Americans pay a lot for payments relative to a lot of other countries. That would be the goal there. But the key is, that would still involve a version of essential bank digital currency. The money that people gave to these intermediaries could be put or could be required to be put in a Federal Reserve master account, where then its only purpose in life was to settle payments that were requested by the customer to be made to another party using another intermediary within that network. That's where a lot of other countries have gone. It's not where the United States has gone yet. But to make a very long story short, the idea of a central bank digital currency is not one thing. It's many things and that the design choices matter a great deal around things like privacy and security, but also around things like the competition within the payment system through to things like the potential financial stability implications of widening access to these accounts.

Alan Kaplinsky:

Well, we've come to the end of our program, but before we close it out, wondering, Ron, whether you have anything you'd like to add?

Ron Vaske:

No, nothing more. This has been very informative, very interesting.

Alan Kaplinsky:

Yeah. Okay. Dan, have I neglected to ask you a question that I should?

Dan Awrey:

No, this has been fantastic. I think we diarize a date being optimistic for about five years from now to see the pickup on FedNow, to see where we are legislatively in the United States with potentially modernizing our payment system infrastructure, and then ultimately looking at how consumers have or have not benefited from all of this hot air, much of it coming out of my mouth around how we need to build and improve our payment systems. Thank you very much for having me. It's been fantastic.

Alan Kaplinsky:

Yeah. Well, thank you very much for joining us today, again. I'm sure we'll be in touch some more as developments occur that probably we're not even thinking about right now. To make sure you don't miss our future episodes, you should subscribe to our show on your favorite podcast platform, Apple Podcast, Google, Spotify, or wherever you listen. Don't forget to check

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