The Federal Reserve’s Role in the U.S. Payments System

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Our legacy began on December 23, 1913. That’s when President Wilson signed the Federal Reserve Act “to provide for the establishment of Federal Reserve Banks, to furnish an elastic currency to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes.”
The Role of the Federal Reserve

- **Monetary Policy**
- **Banking Supervision**
- **Financial Services**

**Financial Services**
- Ensure the safety, efficiency, and accessibility of the U.S. payments system
- “Bank for banks”
  - Currency and coin ordering
  - “Wholesale” payments (Fedwire and book-entry securities)
  - “Retail” payments (check clearing and ACH)
  - Settlement
- “Fiscal Agent” for the U.S. Treasury
  - Maintain accounts for the U.S. Treasury
  - Process government payments
  - Disburse electronic Social Security benefits, tax refunds, etc.
  - Develop applications for accounting, Debt and cash management functions
- Provide application hosting
The Federal Reserve’s Role in Payments

As part of the Federal Reserve Act, Congress also tasked the Fed with providing a safe and efficient method of transferring funds throughout the country’s banking system. The Act mandated regional Reserve Banks to provide check clearing services to member banks, which became the first nationwide check-clearing system in the country. Over the past decade, the Fed has led the industry’s push to replace paper forms of payment – such as checks – with electronic forms of payment that offer lower risk and higher efficiency.
FRFS Continues its Commitment

Mission
• To foster integrity, efficiency and accessibility of the U.S. payments system

Vision
• Payments are safe and efficient
• End users can select payment options with attributes (e.g., speed, convenience, cost, security) that meet their needs
• Incentives promote efficient selection and use of these options

Role
• Act as a major service provider to the interbank market
• Collaborate with industry and emphasize innovations in electronic payments systems
Federal Reserve Roles in Payments

**Leader/catalyst**
- Act as advocate, educator, or change agent, and seek to influence payments system policy through a variety of means

**Service provider**
- Operate the Fedwire® Funds, FedACH®, FedCash®, Check Services and FedLine® access solutions
- Seek to enhance existing and develop new services that improve the payments system and better meet end user needs

**Fiscal agent**
- Provide a broad set of services to the U.S. Treasury, government agencies and other fiscal principals in our capacity as fiscal agent and depository
Federal Reserve System (FRS) Payment Services

- Distribute currency and coin
- Process and clear checks
- Operate a large dollar electronic funds transfer system, called Fedwire
- Operate an electronic securities issuance, transfer and safekeeping service (Fedwire Securities)
- Operate a small dollar electronic funds transfer system called the Automated Clearinghouse (ACH)
- Operate an interbank settlement system called the National Settlement Service (NSS)
- Operate an access solution called Fedline that allows banks direct access to FRS payment systems
Fedwire Funds Service

- Real-time gross settlement (RTGS) system
- Participants initiate funds transfers that are immediate, final, and irrevocable once processed
- Credit transfers only
- Typically used for high-dollar transactions and/or transactions with a need for immediate funds availability
- FIs must hold a Fed account to be eligible to participate
Fedwire Securities Service

• Issue and settle federal government and commercial securities
• Provides safekeeping, transfer and delivery
• Electronic safekeeping of all marketable U.S. Treasury securities, as well as securities issued by federal government agencies and certain international organizations
• Processes securities in real time with final, irrevocable funds
Automated Clearinghouse System (ACH)

• Developed in the mid-1970s

• Originally a system to replace paper checks
  — Originally used magnetic tapes
  — 1994: All-Electronic ACH

• Designed to process mostly recurring payments like Direct Deposit of payroll; debit of utility payments

• Today, used extensively to process one-time debits
  — For example converted check payments and payments made over the telephone and Internet
Automated Clearing House (ACH)

- Nationwide network
- Open to all Financial Institutions (Banks and Credit Unions)
- Batch processing, “store-and-forward”
- Credits and debits
  - Direct Deposit of payroll, social security benefits, and tax refunds are typical examples of ACH credit transfers
  - Direct Debit/Direct Payments of mortgages and utility bills are typical examples of ACH debit transfers
- Settlement takes place the next business day
  - ACH credits can be sent to the Fed 1 or 2 days in advance of the intended settlement date; debits only 1 day in advance
  - New rules go into effect soon that allow for same day ACH processing
Check Processing

• For checks collected through the Fed
  — Accounts of collecting FIs are credited for the value of the checks deposited for collection
  — Accounts of paying FIs are debited for the value of checks presented for payment

• Since the advent of image-exchange (Check 21), most checks are now collected and settled within one business day
Check Processing

• Most checks processed by the Fed today are deposited and presented using the Fed’s electronic check collection services

• Significant drop in check writing led to consolidation of Fed check processing sites
  — In 2003, the Fed had check-processing operations at 45 locations
  — Since early 2010, paper checks are processed only at the Atlanta Fed
Check Processing

• The number of checks written in the US has been declining since the mid-90s as the use of electronic payment instruments has grown.
Natl. Settlement Service (NSS)

- Multilateral settlement service
- Owned and operated by the Fed
- Enables interbank settlement between large financial institutions
- Offered to FIs that settle for participants in clearinghouses, financial exchanges and other clearing and settlement groups
- Files processed on receipt and posted to FI accounts immediately; Entries final and irrevocable
- Used extensively by credit card companies
Cash Services

• FRS distributes currency and coin to ensure that FI’s have sufficient supplies to meet public demands

• 28 Fed offices/branches provide cash services
  — Serve approximately 9,200 FIs in the U.S.

• FR Board determines the number of new Federal Reserve notes needed each year

• Fed pays BEP the cost of printing new currency

• Arranges and pays cost to transport currency from the BEP to Fed offices
Cash Services

- Fed purchases notes from the Bureau of Printing and Engraving.
- Cost is about $48 per 1,000 notes.
- Average life span of $1, $5, and $10 is 18 months; $20 bill is 2 years.
- Coins minted in 2 locations: Denver and Philadelphia; average life span is 20 years.
Coin

- U.S. Mint is issuing authority for coins and determines annual coin production
- Fed provides the Mint with monthly coin orders and a 12-month coin-order forecast
- U.S. Mint transports coins for circulation from its Philadelphia and Denver production facilities to all Feds and the Fed’s coin terminal locations
- FRBs distribute new and circulated coin to FIs to meet public demand
FedLine Transaction Volume and Value

- FedLine enables financial institutions to securely access Federal Reserve Bank functions (e.g. Financial Services, Central Bank Services, etc.)
- Serving over 12 thousand U.S. financial institutions across twelve Districts
- Over 75 million payments daily valued at more than $4.7 trillion

2014 FRFS Volume/Value*:
- 135 million Fedwire Funds transfers, value = $885 trillion
- 17 million Fedwire Securities transactions value = $287 trillion
- 6 billion Check transactions value = $8 trillion
- 13 billion FedACH transactions value = $24 trillion

*Source: Board of Governors site
Federal Reserve’s Strategic Focus for U.S. Payments System

**Safety and Security**
- Maintain and enhance Federal Reserve Bank network security
- Enhance understanding of end-to-end security
- Collaborate and promote industry best practices

**Speed**
- Develop solutions to enhance payment speed
- Understand market demand for faster payments
- Continue migration of paper to electronic

**Efficiency**
- Develop solutions to promote efficiency
- Understand needs and barriers
- Promote standards adoption to improve efficiency
The Federal Reserve Act stipulates that, when required by the Secretary of the Treasury, Reserve Banks will act as fiscal agents and depositaries of the United States.

As fiscal agents of the Treasury, historically Reserve Banks: 1) auction and safe-keep US Treasury securities, 2) issue and redeem savings bonds, 3) monitor collateral pledged to the federal government by depository institutions, 4) act as depositaries and maintain Treasury’s bank account, and 5) issue and collect payments for Treasury.

In the last 15 years, Treasury has greatly expanded the role of the Reserve Banks to provide material support for Treasury’s payments, collections, cash and debt management and accounting functions. Much of the Federal Reserve’s support for Treasury involves the development and operation of software applications and the operation of business functions.

Treasury reimburses the Reserve Banks for all costs incurred with providing support as fiscal agents. The source of this funding is in the “permanent and indefinite” appropriation created by Congress. This funding is not subject to Congress’ annual appropriations process, it remains in place permanently. OMB reviews the level of permanent and indefinite (P and I) each year.
Scope of Federal Reserve Fiscal Agent Support

- 33 different applications or support functions
- 1,500 ANP/FTE supporting Treasury systems
- Currently all 12 Reserve Banks do something to support Treasury
- U.S. Treasury is largest user of Fed payment services
- Central office that coordinates all Fed support for Treasury is at Fed St. Louis (Treasury Relations Office)
- Effort underway to consolidate support to 3 “core” Reserve Banks and 3 “single function” sites
Payment Services Provided to the U.S. Treasury

- Check processing
- ACH payments – both domestic and international
- Wire transfer processing
- Savings Bonds/Retail Securities: printing, distribution, redemption
- Sale/auction and redemption of Treasury Bills/securities
- Smart Card System for military bases
- Internet site (Pay.gov) used for collecting non-tax funds into the government
Other Fed Support for Treasury

• Application development, testing and hosting
• Call center support/Help Desk for Tier 1 application support (password resets, user re-certification)
• Business operations- collateral monitoring of financial institutions, electronic invoicing support, etc.
• Treasury Account Monitoring – report daily balances and ensure no out of balance conditions exist
• Forecast balances in Treasury account
• Communications and market research for major government programs and initiatives
• Data Analytics – identification of improper payments
Questions?