



## Share your views on improving the U.S. payment system



In October 2012, Sandra Pianalto, president and CEO of the Federal Reserve Bank of Cleveland and chair of the Federal Reserve Banks' Financial Services Policy Committee (FSPC), opened the Chicago Payments Symposium with an overview of the areas of strategic focus for Federal Reserve Financial Services in her keynote address, "Collaborating to Improve the U.S. Payments System". These areas of focus were also highlighted in a November 2012 *FedFocus* article entitled, "Aligning strategic focus and collaborating with the industry on payments system improvement." We shared our plans to focus efforts on further improving the speed, efficiency and safety of the U.S. payment system and helping overcome barriers to migrating personal and business payments to electronic channels. Since then, extensive research and industry engagement have been completed to advance our strategic focus.

On September 10, 2013, the Federal Reserve Banks released a "Payment System Improvement – Public Consultation Paper." The public consultation paper shares Federal Reserve perspectives on the key gaps and opportunities in the current U.S. payment system and identifies the desired outcomes that close these gaps

and capture these opportunities. The Federal Reserve Banks are seeking the input of payment system participants and end users on gaps, opportunities and desired outcomes articulated in this paper; potential strategies and tactics to shape the future of the U.S. payment system; and our role in implementing these strategies and tactics.

### IDENTIFYING GAPS AND OPPORTUNITIES

The consultation paper highlights gaps and opportunities identified through a secondary research effort which involved reviewing close to 300 papers, articles and research reports on issues related to the speed and efficiency of payments.

#### Continued end-user check writing

End-users are still writing paper checks by the billions across many different use cases. Check writing persists because checks have important attributes, including ubiquity and convenience, which are not well replicated by electronic alternatives for some transactions. For example, checks are ubiquitous, meaning any two parties with a bank account can pay one another with checks without enrolling in an additional service. Checks are also convenient because the payer does not need to know the payee's account information and the payee can cash a check without having an account. In addition, many receivers of checks prefer other forms of payment, but exercise little control over the sender to request a preferred form of payment.

Accelerating the conversion of payments from paper to electronic will bring down the end-to-end cost of initiating and receiving payments and enhance efficiency. While innovators will continue to create new customer-facing technologies to help users initiate payments electronically, the alternatives available today generally lack the broad reach of checks.

#### Closed payment communities

Most recent payment innovations facilitate easier electronic payments, but have yet to gain significant market penetration and are still limited-participation or "closed" systems where both the sender and receiver must join. While the closed-loop nature of these systems may be driven by valid business and risk management needs, a more efficient mechanism would facilitate payments from any sender to any receiver. Thus, legacy U.S. payment systems tend to be more ubiquitous, making them

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efficient and accessible for those who already maintain a transaction account with their bank (payers and payees of any transaction).

### Lack of contemporary features in traditional payment channels

In a world that is becoming more real-time, some features that are increasingly desired by end users are generally lacking in many legacy U.S. payment systems, such as:

- ◆ a real-time validation process assuring the payee that the payer's account exists and it has enough funds or available credit to cover the payment;
- ◆ assurance that a payment will not be returned or reversed;
- ◆ timely notification to the payer and payee that the payment has been made;
- ◆ near-real-time posting and availability of funds to both the payer's and payee's accounts; and
- ◆ masked account details, eliminating the need for end users to disclose bank account information to each other.

Payment cards and wire transfers possess some, but not all, of these features; check and ACH payments generally lack these features. Several innovators have attempted to address these gaps with new services, but these are offered within the constraints of closed payment communities.

### Faster payments

In a world where several other countries are moving to ubiquitous near-real-time retail payment systems, the U.S. payment system does not have this capability. The U.S. payment system has begun to migrate incrementally toward faster payments; but these innovations, when considered in total, have not resulted in a ubiquitous near-real-time system.



### Obstacles in international payments

The gaps and opportunities related to speed and efficiency of payments are magnified across the international payment landscape. In general, cross-border payments from and to the United States are generally slow, inconvenient, costly and lack transparency regarding fees and timing. This is especially true for bank account-centric international payments sent or received on behalf of consumers or businesses. Some closed networks have made advances in this area, but lack the ubiquity of open banking networks. The continued dramatic growth in cross-border commerce will accentuate this gap over time.

### Mobile technology revolution

Mobile devices have potential to transform wide ranging aspects of business and commerce, including the payment. Digital wallet applications on mobile devices provide merchants with valuable information that can be leveraged for commercial purposes such as consumer-specific location information, transaction history and other context-specific data. With some digital wallet applications, the payment instrument is selected during the initial set-up phase and the payment takes place in the background thereafter, reducing the visibility and choice of payment instrument at the point of sale.

This revolution, characterized by innovation and disruptive technology, is challenging traditional payment business models and presenting new risks and opportunities for all stakeholders. Payment service providers are seeking to define their service offerings in this new world.

### Security concerns

Consumer fears about payment security sometimes inhibit adoption of electronic payments. We have additional analysis on U.S. payment system safety underway. As other key safety gaps are identified, we will work with the industry to determine which industry bodies are best suited to address them.

### DESIRED OUTCOMES

To address the gaps and opportunities in the current payment environment, the Federal Reserve Banks have proposed in the paper five desired outcomes to be achieved within 10 years.

1. **Strategic industry engagement** - Key improvements for the future state of the payment system have been *collectively* identified and embraced by payment participants, and material progress has been made in implementing them.
  2. **Ubiquitous real-time retail payments** - A ubiquitous electronic solution(s) for making retail payments exists that does not require the sender to know the bank account number of the recipient. Confirmation of good funds will be made at the initiation of the payment<sup>1</sup>. The sender and receiver will receive timely notification that the payment has been made. Funds will be debited from the payer and made available in near-real-time to the payee.
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3. **Improved efficiency** - Over the long run, greater electrification and process improvements have reduced the average end-to-end (societal) costs of payment transactions and resulted in innovative payment services that deliver improved value to consumers, businesses and governments.
4. **Improvements in cross-border payments** - Consumers and businesses have better choice in making convenient, cost-effective and timely cross-border payments from and to the United States.
5. **Enhanced payments safety and security** - The Federal Reserve Banks have collaborated, as appropriate, with the industry to promote the security of the payment system from end-to-end amid a rapidly evolving technology and threat environment. In addition, public confidence in the security of Federal Reserve Financial Services has remained high.



## SHARE YOUR VIEWS

Success in improving U.S. payment system speed and efficiency, while preserving safety, will require collaboration across the industry. The Federal Reserve Banks need to understand industry views on the benefits and costs of addressing these gaps and opportunities, the technical and operational impacts of potential solutions, and the associated safety issues. The consultation paper is available at [FedPaymentsImprovement.org](http://FedPaymentsImprovement.org), and responses may be submitted until December 13, 2013.

In addition to providing written comments, industry stakeholders are invited to discuss their views with Federal Reserve Bank leaders at a number of key Fed and industry forums this fall including Sibos 2013, the Chicago Payments Symposium, Money2020, the ABA annual conference and the

AFP annual conference. More information on these opportunities is available on our Industry Events page at [FRBservices.org/eventseducation/industryevents/index.html](http://FRBservices.org/eventseducation/industryevents/index.html). Additionally, Federal Reserve Bank-hosted open forums are in the planning stages with final dates and locations to be announced in the coming weeks.

The input of payment system participants and end users will help the Reserve Banks as we define and prioritize U.S. payment system improvement initiatives that advance the speed, efficiency and security of payments. We will communicate these improvement initiatives in a white paper expected to be published in the second half of 2014.

Federal Reserve Banks believe that collaboration and engagement with the industry is the foundation of any enduring strategic improvements to the U.S. payment system. We look forward to public input to this consultation paper as we jointly explore the most promising ideas for U.S. payment system improvements.

<sup>1</sup>‘Good funds’ means that the payer’s account is valid, funds or available credit are sufficient to cover the payment, and therefore, the payment will not be reversed for lack of funds.

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## In pursuit of a better payment system.

The U.S. payment system is undergoing a remarkable period of change, driven by rapid adoption of technology and evolving end-user expectations. The Federal Reserve Banks believe that collaboration and engagement with the industry is the foundation of any enduring strategic improvements to the U.S. payment system.

The Federal Reserve Banks have released the “Payment System Improvement – Public Consultation Paper” to articulate our perspectives on the key gaps and opportunities in the payment system and identify the desired outcomes that close these gaps and capture these opportunities.

### *We'd like your insight.*

We need your input to guide and advance solutions to improve the end-to-end speed, safety and efficiency of the U.S. payment system. We'd like your perspective on the information presented in this paper; potential strategies and tactics to shape the future of the U.S. payment system; and our role in implementing these strategies and tactics.

### *Join the conversation at [FedPaymentsImprovement.org](http://FedPaymentsImprovement.org).*

- ◆ Online: Respond to an online survey
- ◆ Email: Submit your thoughts, opinions and perspectives via email

**Visit [FedPaymentsImprovement.org](http://FedPaymentsImprovement.org) to download your copy of “Payment System Improvement – Public Consultation Paper” and to submit your comments.** Responses may be submitted until December 13, 2013.

