ECCHO

December 13, 2013

Sandra Pianalto
President and CEO
Federal Reserve Bank of Cleveland
1455 E 6th St
Cleveland, OH 4411412201

Via: E-mail

Dear President Pianalto:

The Electronic Check Clearing House Organization (ECCHO) appreciates this opportunity to provide its views to the Federal Reserve regarding the issues and questions raised by the Federal Reserve's "Payment System Improvement – Public Consultation Paper".

Our comments are included in the attached document.

Sincerely,

David Walker
President and CEO

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ECCHO Response to the Federal Reserve's
Payment System Improvement – Public Consultation Paper

December 13, 2013

The Electronic Check Clearing House Organization ("ECCHO") appreciates this opportunity to provide its views to the Federal Reserve regarding the issues and questions raised by the Federal Reserve's "Payment System Improvement – Public Consultation Paper" (the "Consultation Paper").[1]

ECCHO is a not-for-profit national check clearinghouse owned by its over 3,000 member financial institutions dedicated to promoting electronic check collection and related payment system improvements. ECCHO is recognized across the U.S. as the national provider of private sector check image exchange rules. During 2012, ECCHO member financial institutions used check images to exchange under the ECCHO check clearinghouse rules approximately ten billion transactions totaling $13.8 trillion.[2]

ECCHO has provided below its comments regarding the Federal Reserve's establishment of a framework for evaluating possible changes to the U.S. payment system as described in the Consultation Paper. In certain cases, we do not have enough information to provide a final view or opinion on certain of the questions and issues raised in the Consultation Paper. In these cases, we have identified issues that may need expanded review, at the appropriate time in the development process, by the Federal Reserve alone or in conjunction with the financial services industry, business and consumer payment system users and other payment system stakeholders.

1. Comments on the Role of the Federal Reserve In Payment System Development

ECCHO supports the Federal Reserve's efforts to consider improvements to the payment system and to coordinate with financial services industry, businesses, consumers and other payments system stakeholders to evaluate what improvements are needed or are appropriate for the payment system. The numerous technological developments over the last decade, including online payment services, check imaging, smart-phones, and ubiquitous, fast and efficient data communications and data storage and retrieval, have created a new paradigm for innovation in payment system products and services. We anticipate that the pace of these technological developments impacting the payments system will continue to accelerate, at least for the foreseeable future. In light of these past and anticipated future technological developments, it is an appropriate time for the Federal Reserve, the financial services industry and other payment system stakeholders to consider possible changes to the current payment system or development of a new payment system.

[1] This letter does not represent the view of all ECCHO members, certain of which may submit their own comment letters on the Consultation Paper.
[2] For more information regarding ECCHO, please see ECCHO's web page at www.ECCHO.org.

ECCHO believes that the Federal Reserve should act cautiously in steps it takes to develop a new Federal Reserve-centric or -controlled payment system. ECCHO believes that the Federal Reserve should focus its efforts on improvements to the existing payment system or development of a new payment system that increases options for the financial services industry, its business and consumer customers and other payment system stakeholders. The Federal Reserve should give priority to encouraging financial services industry innovation and ownership of any new payment system, as opposed to Federal Reserve ownership and mandated usage. As recognized by Congress in adopting the Monetary Control Act of 1980[3], private sector participation and ownership in the payment system in competition with the Federal Reserve promotes payment system innovation and efficiency to the benefit of all payment system users.

Specifically, ECCHO supports market-driven migration from the current payment systems to future payment system options. Business and consumer payers and payees should have the freedom to select a payment system that they feel meets their business and payment needs. Similarly, financial institutions should make choices on which payment types to offer to their customers and how to promote and support those various payment types. We do not support payment system changes that are dependent upon mandated migration by financial institutions and their customers from the existing payment systems to a new payment system.

Furthermore, ECCHO would oppose Federal Reserve or other government action to mandate the sunsetting of the check system or any other payment type in the context of development of a new payment system. The Federal Reserve or another governmental entity should not place its judgment regarding the merits of the check system relative to other existing or new payment systems over the decisions payers and payees make millions of times each day in selecting a system to make or receive their payments. These decisions of payers and payees should drive payment system improvements.

We do want to emphasize that ECCHO is not opposed to improvements in the non-check electronic payment systems, as alternatives to the use of paper checks by payers and payees. ECCHO would support improvements to the non-check electronic payment systems even if resultant growth in non-check payment alternatives would come at the expense of check payments over time. ECCHO views its role as supporting and promoting efficient check payments, so long as there is market demand that check payments meet. As described in more detail in the responses below, ECCHO believes the Federal Reserve could make changes to the current check system to make check payments more efficient and thereby achieve certain of the Desired Outcomes identified in the Consultation Paper.

The Federal Reserve's leadership and experience with Check 21 Act and image exchange offers an appropriate model for the Federal Reserve's role in future payment system developments. The Federal Reserve provided valuable leadership both for the development of

[3] 12 U.S.C. 248a, 94 Stat. 140 (March 31, 1980) and 101 Stat. 652 (August 10, 1987).

the legislative and regulatory structure for substitute checks and for the operational implementation of substitute check creation and presentment. The Check 21 Act, combined with the Federal Reserve's operational support for check imaging and substitute check printing, all provided the means for banks to move to check image exchange, as the banks made their market-based decisions to invest in their internal systems to support check image exchange. Check 21 was a success, and banks migrated to the new check image exchange within a few years of adoption of the Check 21 Act, because check image exchange enabled efficiency gains for banks and new products (e.g., remote deposit capture) that bank customers desired. The success of check image exchange did not result from a legislative or regulatory mandate to use check images or to end paper check exchange. Rather, check imaging resulted from market participants making decisions in their own interests to implement or utilize check images, after Congressional, Federal Reserve and industry leadership to provide legal, operational and other support to enable these market-based decisions.

2. Focus Federal Reserve Efforts on Improvements to Existing Payment Systems

ECCHO is of the view that improvements to existing payment systems for one or more particular payment types (e.g., check, ACH, and/or card) could achieve some or all of the Consultation Paper's stated Desired Outcomes. In this regard, the Federal Reserve should consider whether such improvements to the existing payment systems could arise from (i) technological and other innovation within the private sector; (ii) leadership from the Federal Reserve to support legal changes (e.g., federal or state legislative changes, Federal Reserve or other agency regulations); and/or (iii) technological or other improvements to the Reserve Bank and private sector inter-bank exchange systems for check and ACH payments.

In the legal area, the Federal Reserve could support changes to the legal rules governing check payments which would allow for new payment products and/or greater efficiency in these existing payment systems. For example, in the check collection area, there has been discussion over the last few years of allowing the creation and exchange of check images between payers and payees that are fully electronic and do not arise from a paper check. These fully electronic items are generally referred to as "EPOs." Because of the success of Check 21, the investment in the infrastructure within the banking system to clear EPOs has already been made and amortized. There is not a need for substantial additional investment by the Federal Reserve or other payment system stakeholders to complete this end-to-end experience. As such, this enhancement should be relatively quick to implement, particularly for certain uses of EPOs such as B2B payments. This enhancement for the processing of EPOs has the added benefit that it would not take away resources or capacity from the existing check image system or from other payment system enhancements or solutions. If this enhancement to the check system is not desired by payers and payees or there are better options for enhancement to the check system that are identified in the future, then the enhancement to support EPOs will not succeed in the marketplace. The Reserve Banks have already undertaken a leadership role in identifying legal barriers that may exist to the use of EPOs as a payment product by hosting the Electronic Payment Order Forum in March

2013. The Federal Reserve should continue its efforts to study potential business cases for EPOs and the legal and regulatory changes that may be necessary to support those business cases.

One additional operational and legal change to the existing check system that ECCHO recommends that the Federal Reserve consider is permitting a Reserve Bank to deliver check image files between two banks without the Reserve Bank acting as a collecting bank on the check image. Today, the Reserve Banks act as collecting banks in all forward exchanges and returns of check images and paper checks through the Reserve Bank system. This collecting bank exchange requires that the check image meet the Reserve Bank's eligibility requirements and quality control standards. In addition, the Reserve Bank is subject to potential liability under the UCC and Regulations CC and J for the check image itself in certain situations (such as late return of the check image or bad quality images). The Federal Reserve could make operational and legal changes (to Regulation J and Operating Circular #3) to permit depository institutions to exchange check images though the Reserve Banks in a manner where the Reserve Banks acted as a central operator, and not as a colleting bank, in connection with the delivery of the check image files and related check image data between the presenting bank and the paying bank (for forward exchanges) or the returning bank and depositary bank (for return exchanges). Operating in this manner would be analogous to how the Reserve Banks act in the ACH system where they serve as a central operator and do not have any settlement or legal liability for the underlying ACH entry itself.

We believe that, if the Reserve Banks acted as an operator to support check image exchanges between depository institutions, it would allow private sector depository institutions to innovate in offering check image based payment products to their customers. Private sector depository institutions could reach a greater number of their depository institution partners, and would not be limited by rules and technological constraints that the Reserve Banks impose on check images when acting as a collecting bank. We recognize that there are potential risk and operational issues that would need to be identified and fully evaluated in considering this possible approach to check image exchange through the Reserve Banks.

3. Undertake Deeper Analysis of Issues Associated with Each Different Payment Type

In evaluating the Desired Outcomes and possible revisions to the current payment systems, the Federal Reserve should consider the different needs and features of each payer/payee payment type. There may even be sub-types within each payment type that need to be considered separately. We believe this more refined analysis will demonstrate that the current payment system options are meeting the needs of many of these payer/payee types, or that only limited improvements to the existing payment systems are needed for other payer/payee types. Alternatively, it may be determined that the needs of only certain payer/payee payment types are not being met by the current payment system options and only these limited payer/payee payment types should be the focus of the Federal Reserve's efforts to improve the payment system. For example, we believe that different payer/payee types will have different views on the extent to which the five features identified in the Consultation Paper as "desired increasingly by end users" are in fact desired.

We recommend that the Federal Reserve separate out at least the following payer/payee types for individual evaluation against the payment system features desired by end-users:

- Business to business payments (B2B)
- Consumer to consumer payments (C2C)
- Business to consumer payments (B2C) – It may be appropriate for the Federal Reserve to treat recurring payments (such as payroll payments) separately from "one-off payments" (such as insurance payments or purchase refunds). These two subsets of B2C payments appear to raise different operational and business needs. For example, in the case of recurring payments, the business typically has an ongoing relationship with the consumer that facilitates the payment, which we believe impacts the payers' and payees' payment needs.
- Consumer to business payments (C2B) – It may be appropriate for the Federal Reserve to treat retail POS payments (consumer is in the store taking goods out) separately from invoice payments (consumer is paying funds owed for ongoing account, such as a utility payment). These two subsets of payments would appear to raise different risks to the payee and therefore may require different payment system enhancements.

There may not be one single improvement or new payment system that can work for all of the above payment types. For example, B2B payments may not need the same solution or system enhancement as C2B payments. Similarly, B2B payers/payees may be relatively less interested, or not interested at all, in certain of the Desired Outcomes listed in the Consultation Paper. For example, all or some corporate payers or corporate payees in B2B or C2B payments may not need or even be interested in account number privacy for the bank accounts used for these corporate payments because these account are frequently closed off for debit payments or are subject to positive pay services that control against fraud on the account. Similarly, all or some corporate payees in a B2B payment may not need guarantee of payment at the time of delivery of the goods, since the business payee frequently absorbs risk of failed/NSF payment when billing by means of invoice to another business. Finally, as compared to consumer payments, some corporate payers and corporate payees in B2B or C2B payments may be more interested in a new/improved payment option that has full remittance data and/or increases the efficiency of the payer's or payee's back office, as opposed to any of the listed Desired Outcomes.

In the context of B2C payments, a large number of B2C payments are recurring payroll, retirement and other benefit payments. All or many of these B2C payments may not need all of the stated Desired Outcomes in the Consultation Paper, as the current payment systems (check and ACH) meet the full payment needs of these B2C payments. These payments are typically handled in large, pre-scheduled batches within the ACH and check systems. These recurring B2C payments may not need guarantee of payment/settlement for the receiver of the payment as there is relatively little or no risk to the receiver from these payments, and there seems to be no or only a limited need to speed up the processing of these recurring B2C payments, relative to other of the payment types discussed above.

For each of the above payment types, the Federal Reserve should also consider whether or not there are different business needs and solutions for payments that are initiated as a credit payment to the receiver and payments that are debit payments initiated by the receiver to pull funds from the sender's account. For example, for recurring payments by consumers, would a credit type system have features that would allow for recurring credits to pay a merchant? Or would there still need to be functionality for the merchant to initiate recurring debits for certain types of consumer payments?

4. Consider Strategy for Implementing Improvements Across Multiple Systems

As discussed in the prior section, we believe that there is not one single payment enhancement or solution for improving the payment system. Rather, we believe that multiple payment system enhancements/solutions are needed for the different payment scenarios and types discussed above. Assuming this is the case, the Federal Reserve should seek input from stakeholders to identify these enhancements and solutions and how these enhancements or solutions should be implemented going forward. The Federal Reserve and other stakeholders should consider whether the enhancements and solutions to the different payment systems should be handled serially or in parallel with each other and, if serially, the appropriate prioritization of the identified enhancements and solutions. Implementation may well be a challenge if there are multiple priorities for the enhancements and solutions and limited resources or time for undertaking these efforts. It is ECCHO's view that the Federal Reserve should place a priority on those enhancements and solutions to the existing payment system that can be undertaken with relatively low upfront cost and relatively short lead time for implementation.

5. Elaborate the Value Proposition to Stakeholders of Conversion to a New Payment System

The substantial resource commitment by the Federal Reserve, the private sector financial institutions, and the other payments system stakeholders to a new payment system (such as the new real time credit system discussed in the Consultation Paper) can only be justified if it can be conclusively demonstrated that existing systems, with appropriate improvements, cannot more efficiently satisfy the needs of payers and payees. To this end, the Federal Reserve should evaluate and describe with specificity: (i) which existing payment types need a new payment system, and (ii) why these payment types cannot be accommodated more efficiently with improvements to one or more of the existing payment systems.

To assist stakeholders in evaluating potential changes to the payment system, we suggest that the Federal Reserve set forth the value proposition to different stakeholders from a new payment system, as compared and contrasted to improvements to the current payment systems. The Federal Reserve should set forth its assumptions or proposals as to the following items:

- What volume of payments would be needed for a new payment system in order to support the business case for the development and operation of the new payment system?
- What impact would the shift in volume to the new payment system have on the operation of the current payment systems, if not all payments could migrate to the new payment system?
- What investment of financial and other resources at the Federal Reserve and the private sector would be required to develop and implement the new payment system, as compared to the resources needed to improve the existing payment system to achieve many or all of the same objectives?
- What potential gains in efficiency or other cost savings or operational benefits would accrue to the users of the new payments system and/or society in general from the shift to the new payment system, as compared to the gains potentially resulting from improving the existing payment system?

In addition, we note that the Consultation Paper assumes certain values from the shift to electronic payments from check without setting forth the underlying analysis for such conclusions or assumptions. For example, the Consultation Paper states: "[m]any receivers of checks prefer other forms of payment but exercise little control over the sender to request a preferred form of payment." However, the Federal Reserve provides no empirical or other support for this conclusionary statement. This statement may not be true for all types of electronic payment alternatives to a check or to all types of payees. For example, in C2B, a business payee may prefer a check payment via a lockbox to an electronic payment. Similarly, a payee in a C2B lockbox payment may not care as much about a payment guarantee, and may decline to pay for it as a service, where the payee has an ongoing account relationship (such as a utility) and can easily bill the customer in the event of a returned payment. As another example, in B2B payment, the business payee may prefer a check payment with remittance data compared to an electronic payment that does not include that same remittance data.

Understanding the value proposition of a new payment system and/or enhancements to the existing payment system would allow stakeholders to make a determination whether or not market-driven migration to the new payment system might occur. For example, a guarantee of payment from the payment system generally is desired by businesses and consumers, but there is likely a cost to stakeholders for such a guarantee of payment. If the Federal Reserve were to build a new payment system that had payment guarantee as a required feature, but a substantial number of payment types (such as B2B) do not need or want to pay for a payment guarantee, how will that affect migration to the new payment system? For example, the card system already offers a payment guarantee to the merchant for many types of card payments, but there is a cost to the merchant associated with this feature, which not all merchants appear to want to pay.

Regardless of whether it is determined that a new payment system is needed for a subset of payment types, ECCHO supports the Federal Reserve's continued investing and innovating with the existing check and ACH payment systems. We believe that efforts to develop a new payment system should not come at the expense of the Federal Reserve's support for additional innovation and updates to the current check and ACH payment systems.

6. General Comments on Consultation Paper's Desired Outcomes

The Consultation Paper identifies five Desired Outcomes for payment system improvement that should be achieved in ten years. However, the Consultation Paper does not establish whether there is a priority of the Desired Outcomes. ECCHO believes that the Federal Reserve, the private sector financial institutions and other payment system stakeholders should work together to determine (i) which Desired Outcomes are important/necessary for each payment type and (ii) the relative priority of the five Desired Outcomes from most desired to least desired. For the reasons discussed above in Section 3, we believe that not all payment types will have the same Desired Outcomes or the same priority of Desired Outcomes. The prioritization and applicability of the different Desired Outcomes for each payment type will help the Federal Reserve and other payment system stakeholders make decisions regarding the need for a possible new payment system or enhancements to the current payment system.

A. Comments Regarding Desired Outcome #1

Desired Outcome #1: *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.*

ECCHO recommends that the Federal Reserve revise Desired Outcome #1 at least with respect to material progress on the implementation of a completely new payment system. It is unlikely that the financial services industry and other stakeholders could make material progress in implementing a completely new payment system with the features described in the Consultation Paper within ten years. There are a number of operational and system limitations that hinder achievement of this Desired Outcome #1. For a new credit type system as described in the Consultation Paper, many banks would need new or upgraded DDA platforms and payment system hardware/software to handle a new non-Fedwire credit-type system with features of real time posting to the customers' accounts and possible multiple daily settlements of funds.

As the Federal Reserve is aware, many banks' current DDA systems and payments platforms mostly work on a batch basis and are not capable of posting all credits and debits arising during a day to consumer or business accounts in order to determine a true account balance for approving or denying all payments on the account on a real time basis. These banks would not quickly undertake the substantial investment in the implementation of new or upgraded DDA platforms until there is a high degree of certainty as to the technological features and operation of the new payment system. Similarly, business payees would need new lockbox and payment recordkeeping systems to switch from their check and ACH lockbox processing to the new credit system.

By comparison, for changes and enhancements to the current ACH, check and wire payment systems, there is greater likelihood that such enhancements could be made within the ten year period. This would assume that these changes to the current payment systems can be implemented without banks installing completely new DDA systems and payment platforms. For example, the conversion to the check image exchange system took almost ten years to reach the material progress stage, when one includes both the number of years that were spent piloting the substitute check program and then developing and promoting the legislative and regulatory framework for substitute checks.

B. Comments Regarding Desired Outcome #2

> Desired Outcome #2: *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. 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.*

We agree with the statements in the Consultation Paper that ubiquity is an important element of either a new payment system or any enhancements to the existing payment system. With regard to this ubiquity feature, the Federal Reserve and other stakeholders should recognize that the ubiquity feature of a payment system can increase the risk to that payment system. The same features that may make a payment system easy for payers to pay any payee similarly could increase the susceptibility that fraudsters could use that payment system to initiate unauthorized payments. As such, we recommend that the development of fraud controls and related costs associated with a new ubiquitous payment system should be included when evaluating the feasibility and potential benefits of that new payments system.

Currently the payment systems, other than cash and check, have limitations on consumer initiation of payments to at least some parties. These initiation limits seek to control the fraud risk around the particular payment types. For example, certain merchants are not approved to initiate credit card transactions or ACH debit transactions. These traditional limitations on payment initiation have been declining over recent years as new products (such as smartphone credit card scanners) have made it easier to accept credit card payments. The check system, while the most ubiquitous of the non-cash payment types today, has invested substantial resources in controlling potential fraud through positive pay services, item/signature review, and know-your-customer requirements imposed by the depositary bank on the depositing customer. A new ubiquitous payment system likely will require the development of new fraud and risk controls in substitution of these current controls.

We believe that Desired Outcome #2 and the Consultation Paper in general overstate the importance of the confidentiality of the account number of the payee, at least for certain payment types. As discussed above, business payers/payees can control risk around payees/payers knowing their account numbers by use of positive pay services and debit blocks on their business deposit accounts. For consumer accounts and small business payers/payees, we are seeing that technology and low cost electronic communications are reducing the fraud risks or losses associated with payments where the account numbers are visible. For example, banks can send email, text message and other electronic alerts to customers to inform the customer at the time a payment is posted to his/her deposit account, and consumers can go online on the day a check is posted to the account to review an image of the check.

In evaluating the benefits and risks of a payment system that are not linked to payer/payee account numbers, the Federal Reserve and other stakeholders should consider the risks and complexities associated with one or more national databases of account numbers or other payment credentials that would be needed to substitute for the current payer/payee account number system of making payments. The Consultation Paper does not address or ask for comment on what additional or new expenses would arise from maintaining such a database or the difficulty of providing account holder payment credential information (other than the account numbers) at all times, including periods when account holders are changing accounts, such as when consumers move between financial institutions, close and open accounts at the same financial institution, or add new accounts.

Desired Outcome #2 states that a new payment system would include elements of real time payment where funds are debited and made available in real time. While we agree that any new or enhanced payment system should consider some element of real time payments, there first needs to be clarity among stakeholders regarding what is meant by “real time” payments. First, from the payer’s sending bank perspective, there should be clarity as to whether or not a “real time” feature of a new payment system would require actual posting of the payment transaction to the payer’s account for all purposes, or whether a memo post to the payer’s account is sufficient. From the receiving bank’s perspective, it does not seem appropriate as a float matter for the payment system to require a receiving bank to provide credit to the payee customer earlier than when the receiving bank receives credit for funds from the sending bank. If it is the case that the receiving bank will receive funds from the sending bank, the settlement process becomes more complicated to move funds between the two banks in a manner that matches the posting and debiting/crediting to the respective sender and receiver of the payment during the business day. If the Federal Reserve is anticipating that a new payment system would have multiple settlements during the business day to support real time payments, multiple intra-day settlements between all financial institutions in the United States would significantly increase the complexity to financial institutions of managing their payment operations and related risks and to the Federal Reserve of managing intra-day overdrafts in the financial institutions' Reserve Bank accounts.

A new payment system that has a real time payment feature could introduce new risks which are not present in certain of today's payment systems to the account holding banks and other payment system participants. If the receiving customer has near real time availability to funds arising from the payment, this may increase the risk of fraud since the receiving customer will be able to withdraw the funds or transfer the funds to another remote location where funds cannot be recalled. In a real time system, a sending customer will have little or a reduced amount of time to request a stop payment or other cancellation on the payment. Similarly, the account holding banks also will have a reduced amount of time to review an incoming or outgoing payment to determine risk of possible fraud. These fraud risks, and compensating controls, will need to be considered in evaluating a real time payment system.

The Federal Reserve should provide additional clarity regarding what the Consultation Paper means by the term "good funds" under Desired Outcome #2 and should raise the issue with stakeholders of whether there should be a difference in the payment finality rules associated with any new payment system. The term "good funds" has the potential for different meanings within different parties to a payment. The term "good funds" is commonly understood to mean that there are sufficient funds in the payer's account to fund payment and the payer's account holding institution will settle the payment to the payee receiver. However, depending on the payment type, these payments are still subject to challenge by the payer at a later date and reversal through the payments system to the payee receiver. In the current payment system, from a merchant payee's perspective, there is a difference in the payment finality of check, credit card/debit card, ACH credit/debit payment and wire transfer, even if all these payments settle with "good funds" on the day of the payment. For example, check payments are not generally reversible to the payee receiver through the check system once the check is presented and the midnight deadline has expired. By comparison, debit card, credit card and ACH debits may be reversed by a consumer payer and the consumer payer's financial institution back to the payee receiver through the card/ACH system for a longer period of time (e.g., 60 days) after the payment date. Fedwire transfers are generally settled and not reversible by the sending payer through the Fedwire system. Merchants and certain other payees may have an interest in payment system enhancements that involve fewer situations in which payment can be reversed through the payment system back to the merchant at a later date, even if the consumer payer's financial institution is required to absorb some or all of the loss vis-à-vis its consumer customer.

Regarding the notification of payment under Desired Outcome #2, we suggest that the Federal Reserve provide clarification as to which party is to be notified and by whom, and for what purpose, for each payment type. It is possible that different payment types will have different needs for notification. For example, when a consumer makes a card–present purchase using a debit card or a credit card, the consumer may not need a notification given that he/she was provided the goods or services at the time of the payment.

Finally, the proposed new payment system that is described in Desired Outcome #2, with the exception of the ability to make a payment without an account number, has certain features in common with the current Fedwire system. That is, funds would be delivered based on the instruction of the payer (as opposed to a debit initiated by the payee), and the funds would be "good funds" at the time of delivery. However, the proposed new payment system would go beyond the capabilities of the current Fedwire system in that the proposed new payment system contemplated in Desired Outcome #2 would have the payment settled through to the payer's and payee's deposit accounts, not just settled to the account of the payer's bank and payee's bank at the Federal Reserve, in "near real time." In addition, the proposed new payment system would involve "timely notification" to the payer and payee that the payment has been made, which does not always occur with Fedwire transfers. Given the proposed new payment system's similarities to, and expansion beyond, the current Fedwire system, it is not clear to us how this proposed new payment system would function on a cost-efficient basis such that it would be attractive to senders and receivers of the various payment types discussed above. The operational complexity and transactional costs of the current Fedwire system make it unattractive today as an alternative to ACH credit entries and check payments for most retail payments.

C. Comments Regarding Desired Outcome #3

> Desired Outcome #3: *Over the long run, greater electronification 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.*

The Consultation Paper's discussion of Desired Outcome #3 includes a discussion regarding the reduction in the use of paper checks as one way to achieve greater electronification of payments. ECCHO supports the goal of the electronification of the paper check process as one way of reducing the use of paper checks by businesses and consumers. As the Federal Reserve is aware, due to check imaging, inter-bank check collection currently is virtually 100% electronified. For making the check exchange process between the payer and payee electronic, the Federal Reserve and other stakeholders should evaluate the possible payment applications of EPOs to determine if they can meet this Desired Outcome #3 in a more cost-effective and timely manner relative to other options. Please see our comments on this topic in Section 2 above.

D. Comments Regarding Desired Outcome #5

> Desired Outcome 5: *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.

ECCHO agrees that the Federal Reserve should include security of the payment system as a priority or Desired Outcome for any enhancement to the payment system. We believe that payment system security is an area where Federal Reserve leadership and collaboration with the private sector stakeholders is appropriate, both for the current payment system and any enhancements to the current payment system. The Federal Reserve should include in this Desired Outcome the security and reliability of the Federal Reserve's settlement services that support both the Federal Reserve's settlement of payment transactions processed through the Reserve Banks and the settlement of private sector clearinghouses and networks. The Federal Reserve should seek to achieve this Desired Outcome in a manner that promotes the private sector as a provider of the new payment system or enhancements to the current payment system. Please see our comment regarding the role of the Federal Reserve in Section 1 above.

7. Comments to Consultation Paper's Questions 13 and 14 Relating to Payment Electronification

The bulk of the sub-questions in Questions 13 and 14 are around whether the Federal Reserve should take action to encourage the shift from paper checks to alternative electronic payments (ACH, card or other types). These Questions ask whether the Federal Reserve should set a date for having a specific percentage of all non-cash payments handled in electronic form, and what "tactics" or "incentives" should there be for encouraging the shift from paper checks to electronic payments.

ECCHO does not view these questions as relating to the fundamental issue at hand of whether a new payment system or enhancements to the current payment system are needed in the United States. The possibility of the Federal Reserve of using incentives, other than new payment types and features, to move payments between the existing payment systems is not itself innovation or enhancement to the current payment systems. ECCHO is not opposed to migration of check payments to other electronic payment alternatives. Rather, ECCHO's role is to support check image exchange as an alternative for payers and payees that select the check payment option, and ECCHO does not oppose payers and payees and their banks from migrating to electronic payment alternatives if they determine that those alternatives better meet their respective payment needs.

At a fundamental level, the Consultation Paper does not set forth survey or other data that would support the conclusion that a check payment is less efficient or less desired by payers or payees for all or certain of the payment types where check represents a significant volume of payments. Moreover, ECCHO feels that the migration from check to electronic payment alternatives, if it is to occur, should occur as dictated by payers' and payees' payment system selections based on business cases, prices, and technological developments. Migration should not come from artificial mandates or incentives from the Federal Reserve or another governmental entity, but rather from the decisions of payment system users.

8. <u>General Comment on the Role of Card System in Payment System Innovation</u>

ECCHO does not have any specific comment or recommendation regarding the relationship of the credit and debit card systems to any future enhancement to the U.S. payment system. ECCHO does note that the Consultation Paper does not fully take into account the current substantial role of the card system in retail payments, and what impact the current card system, or future enhancements to the card system, may have on future innovation in the other payment systems, such as check and ACH.

Based on Federal Reserve's studies, 61% of all non-cash, non-Fedwire payments are debit card, credit card and prepaid card payments. The Federal Reserve has limited authority over and operational experience or expertise with card systems, as the Federal Reserve does not process credit card, debit card or prepaid card transactions. This volume of retail card payments and the lack of Federal Reserve insight into or control over the card systems suggest that the potential payment alternatives supported by the card systems should be a factor that the Federal Reserve weighs when determining potential enhancements to the other retail payment systems. The Federal Reserve should consider whether current or enhanced card systems could meet some or all of the needs identified in the Consultation Paper for specified payment types, such as consumer to business retail payments at the point of sale. It is possible that the card systems themselves, or other payment companies or entities that provide payment services supported by the card system, could innovate in the near future to address certain or all of the Desired Outcomes in the Consultation Paper across the various payment types.

9. <u>General Comment on Usefulness of Other Countries' Experiences With Payment System Improvements</u>

The Consultation Paper makes a number of statements that other countries are moving to real time payment systems. However, the Consultation Paper does not identify the specific countries that have moved to such systems and does not describe which type of payments (B2B, C2B, etc.) have been a part of that migration. In addition, the Consultation Paper does not provide any information regarding the volume of payments processed by these countries' real time payment systems or what was the experience of the local financial institutions and their consumer and businesses customers when migrating to a real time payment system. The Federal Reserve should identify the relevant countries and payment systems and provide more information regarding which foreign country models the Federal Reserve is looking at for comparison purposes. This information would help other stakeholders evaluate the usefulness of these foreign payment systems as potential models for changes and enhancements to the U.S. payment system.

ECCHO is concerned that experience with payments in foreign countries may not be particularly relevant or translatable to the U.S. business and banking structure. The United States has a large and diverse national market that must be supported by the U.S. payment systems. The U.S. payment systems include numerous participant types, both financial institutions and non-financial actors, and an established and widespread communications network. These characteristic of the U.S. market and payment systems are not found in many other countries. ECCHO is also concerned that other countries may have achieved their "real time" payment system with the assistance of a government-mandated or encouraged payment solution, rather than a market-driven solution or a solution that included consensus decisions from private sector stakeholders. As discussed above, ECCHO believes that a market-driven approach to payment system innovation will result in the best long term solutions for all payment system participants.

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ECCHO appreciates this opportunity to provide its comments to the Federal Reserve's Consultation Paper. We look forward to working with the Federal Reserve and other payment system stakeholders as this important project moves forward.