EPCOR Comments

Federal Reserve Payment System Improvement Public Consultation Paper

EPCOR is a not-for-profit trade association devoted to providing timely and relevant payments education and support to over 2,200 member banks, credit unions, thrifts and affiliated organizations throughout the central United States.

These comments represent the collective input of the EPCOR Board of Directors, Members and Staff garnered from various meetings and conference calls conducted since the Public Consultation Paper was released.

General Comments/Observations

EPCOR agrees with the Federal Reserve's over-arching problem statement: "*End users of payment services are increasingly demanding real-time transactional and informational features with global commerce capabilities. Legacy payment systems provide a solid foundation for payment services; however, some of these systems (e.g., check and ACH) rely on paper-based and/or batch processes, which are not universally fast or efficient from an end-user perspective by today's standards. The challenge for the industry is to provide a payment system for the future that combines the valued attributes of legacy payment methods – convenience, safety, and universal reach at low cost to the end user – with new technology that enables faster processing, enhanced convenience, and the extraction and use of valuable information that accompanies payments.*"

Role of the Federal Reserve

The Federal Reserve Banks can and should help improve the payment system as a catalyst, a leader and an operator.

- **Catalyst –** By issuing the Public Consultation Paper and hosting various forums to discuss the gaps, opportunities and desired outcomes the Federal Reserve Banks are serving as a catalyst for changes and improvements in the payment system.
- **Leader** – After gathering input from the diverse population of respondents, the Federal Reserve Banks should formulate a position and must then lead the industry toward the desired outcome(s). The Federal Reserve Banks exhibited such leadership with respect to Check 21 and the industry moved to image exchange within a short period of time.
- **Operator –** There are actions the Federal Reserve can take in its role as an Operator that will move the industry toward a faster and more efficient U.S. payment system; among these actions is requiring multiple pick-ups of ACH files by all participating DFIs. Establishing deadlines by which DFIs must comply with additional file pick-up windows will serve as an example to the industry that the Federal Reserve is committed to improving the speed and efficiency of the payment system.
    - Requiring DFIs to pick-up ACH files more frequently can be accomplished through changes to the Operating Circular and requires no formal rule changes.
    - Compliance deadlines can be phased in to require one additional afternoon pick-up in the first 12 to 18 months, and additional pick-ups added at future dates. Institutions and processors can decide how quickly they want to make changes to comply with the most aggressive pick-up schedule.

Collaboration with Payments Infrastructure Participants

The Federal Reserve should foster collaboration among other critical payments infrastructure participants. EPCOR is aware that NACHA developed an ACH Blueprint in March 2012, which addresses many of the attributes discussed in the Federal Reserve Bank's Public Consultation Paper. The Clearing House has also undergone strategic planning on payment system improvements. It is likely that other entities that own the "rails" or write the rules for other payment channels have also looked to the future. It is imperative that the Federal Reserve collaborate with NACHA, The Clearing House and others as a strategic direction for payments is developed.

Define Near-Real-Time Payments

The Federal Reserve Banks must define "near-real-time payments." The Public Consultation Paper articulates desirable features, but is silent on settlement. Until there is a clear vision regarding all aspects of near-real-time payments, the industry will continue to debate the subject and the path to the desired outcome will be muddied by individual interpretations. Specifically, the Federal Reserve Banks need to identify their vision for settlement. Is it real-time settlement? During specified hours? 24/7? Batch settlement? During traditional business hours? Or some other variation? It will be difficult for financial institutions to buy-in to a solution until settlement is defined.

Engage the Money Center Banks

EPCOR applauds the Federal Reserve for engaging the broader payments industry in this dialogue. None of us want a solution that disenfranchises community banks or credit unions or that is not in the best interest of U.S. consumers and businesses. However, the simple reality is that a small number of banks in this country own/control the majority of the DDA accounts and payments business in the U.S. The Federal Reserve must engage the Money Center Banks, as well as community banks and credit unions, in the design of a solution. Without buy-in and support from ALL financial institutions, any initiative, short of a legislative mandate, is destined to fail.

Specific Question Responses

Q1. Gaps & Opportunities

EPCOR is generally in agreement with the gaps and opportunities identified in the Public Consultation Paper, additional thoughts are articulated later in this document.

Q1.i. Other Gaps & Opportunities

EPCOR feels that keeping regulated financial institutions, which have the trust of consumers and businesses, at the center of payments, is critical to achieving the vision of a ubiquitous, near-real-time payment system. Innovators will come and go, but financial institutions assure the safety and security of payments.

Investments must be made in educating consumers regarding payments, and payment safety and security. At whatever point in time a clear vision is identified and a direction is determined, consumer education must begin. If how payments work remains a mystery to consumers, there will be an inherent lack of trust in the system, no matter the convenience or efficiency of the system.

Q2. Desired Outcomes
EPCOR is in general agreement with the desired outcomes, with emphasis on "over the next" ten years. We acknowledge that the desired outcomes will take time to achieve, but action steps need to begin as soon as a clear vision and direction is identified. Waiting and continuing to debate and discuss will only delay achieving the desired outcomes, and will allow more time for unregulated innovators to introduce payment mechanisms that will confuse the market.

Many financial institutions believe that faster payments should happen sooner rather than later. Setting a target date of five years may be more desirable; then if there is a delay, the ten year timeframe may still be achievable. If the target date is ten years and there is a delay, it could be 15 or 20 years until the desired outcomes are achieved, which is not acceptable.

Q2.i. Other Outcomes
EPCOR believes that a mechanism that facilitates the payer making electronic credit payments to the payee, with confirmation of good funds, is preferable to enhancing debit models. Credits would, among other benefits, reduce fraud. A debit process that includes confirmation and/or real-time authorization/approval by the payer would enhance the current debit process, reduce risk and result in fewer insufficient and unauthorized transactions.

Q3. Role of the Federal Reserve Banks
Our thoughts regarding the Federal Reserve Banks' role are articulated above. We emphasize that the Federal Reserve Banks must take a leadership role in improving the payment system for the future.

Q4. Ubiquitous Near-Real-Time Payments
Work is being done within the payment services industry to move toward this desired outcome; however, they are generally slow and lack coordination or consistent vision. Industry Groups tend to have a proprietary view of their endeavors. A Public Authority, a.k.a the Federal Reserve Banks, must take the lead, with appropriate collaboration with other Payments Industry Infrastructure Participants.

Q5. Features of a Near-Real-Time Payments System
EPCOR agrees with the features identified for a near-real-time payment system. What is missing from this list of features is the settlement component. The Federal Reserve Banks need to outline their vision for settlement.

Q6. Different Options for Providing Near-Real-Time Payments

- **Separate Wire Transfer-Like System –** The current wire transfer system provides good funds with immediate settlement and has a clear purpose. Creating a separate system with similar features would add another payment system which is not desirable, could create confusion among participants with respect to which system is most appropriate for their urgent payment needs and could impact revenue associated with wire transfers. Wires do not currently support end-to-end processing features, which is important for B2B payments. The positive aspect of this solution is that the Federal Reserve owns most of the domestic U.S. wire system business, which could make evolving to a new wire transfer-like system more expedient. However, we feel the negatives outweigh this positive.

- **Linking Existing Limited-Participation Networks –** In theory this could be an attractive option; however, encouraging cooperation among proprietary systems could prove to be very challenging. We believe that negotiating common rules and a ubiquitous infrastructure could be nearly impossible. Also, many of these networks are operated by unregulated entities, which could disenfranchise regulated financial institutions.
- **Modifying the ACH –** Of the options presented, modifying the ACH Network seems to be the most viable solution. The ACH is an existing ubiquitous network that can accommodate payment-related data, serves consumer and business payment needs and can support global payments. There are examples of faster processing and settlement of ACH-like systems around the globe, which suggests the U.S. ACH could be modified to achieve the desired outcomes. NACHA has invested time and resources in developing an ACH Blueprint which articulates many of the features the Federal Reserve Banks have identified in their Public Consultation Paper. The Federal Reserve Banks and NACHA should explore the synergies of their independent efforts. If the ACH is to be modified, there will have to be rule changes and financial institutions may deem it appropriate to more fully integrate ACH into their DDA systems, which would be costly. Recognizing these challenges, we still believe that modifying the ACH is the most viable option.
- **Enhancing Debit Card Networks –** Ubiquity, account masking, and for pin-based transactions, confirmation of good funds and near-real-time notification to the DDA, are attributes similar to the desired outcomes for near-real-time payments identified by the Federal Reserve Banks. However, these networks primarily support debits, with limited credit capability. Significant modifications would be necessary for this system to fully support the desired outcomes. Also, high per-transaction costs, fraud rates and related losses, coupled with the ownership/control structure of debit card networks makes this option unappealing.
- **Implementing an Entirely New Payment System -** EPCOR does not believe this is a viable option. Retiring outdated payment channels is not part of our culture, so adding yet another system would increase expense and regulatory burden for financial institutions. However, if it is determined that making significant changes to existing systems would jeopardize the current capabilities of these systems, creating a new system may be the only logical alternative.

Q6.i. Options Not Listed Above
The Federal Reserve Banks might consider developing a single platform for wires and ACH. This would significantly reduce expenses for financial institutions including hardware, software and support costs, as well as simplify OFAC compliance and security. This option would decrease, rather than increase, the payment systems financial institutions must support. Wire features could still be used for urgent payments, including good funds, irrevocability, immediate settlement and enhanced security features, while a modified-ACH could be the backbone of the proposed near-real-time payment system.

Q6.ii. Pros and Cons or Costs and Benefits
Our thoughts regarding pros and cons of the various options are expressed above. With respect to costs, it is recommended that the Federal Reserve Banks undertake a study of the costs for financial institutions and network participants, taking into consideration the fixed costs of modifying an existing system or establishing a new system, as well as projected transaction costs. The costs to all payment system participants will impact the viability of any new system.

Q6.iii. Interbank Settlement
Near-real-time authorization and funds confirmation are essential. EPCOR believes interbank settlement could occur at specified times throughout the day. This could be accomplished in batch-mode, which would be less expensive to implement than continuous flow settlement. Looking to the settlement scenarios of other countries could prove beneficial in determining the frequency of interbank settlement. Moving toward a credit-push model with more frequent settlement would result in less risk than the current debit model.

Q6.iv. Payment Scenarios
P2P, P2B and POS are all well suited to and would expand with the introduction of near-real-time payments. While near-real-time payments are attractive for B2B payments, we believe the biggest hurdle to overcome for electronic B2B payments is straight-through-processing. Until there is a universal solution to address straight-through processing, B2B payments will not migrate quickly to any electronic payment solution.

An ideal solution for B2B payments would be one in which all data related to payments could be made available to businesses in a common format, regardless of the channel.

Q7. Easier Check Payments/Fully Electronic Payment Orders
Checks seem to be most widely used by older consumers, businesses and when no other form of payment meets the intended need, such as low dollar P2P transactions. The Federal Reserve has done some work to understand the opportunities and barriers associated with Electronic Payment Orders (EPOs), which at best would be an incremental benefit to the industry. It appears that broad adoption of EPOs would require legal and regulatory changes that would be time consuming, burdensome and detract attention away from the desired outcomes. Unless it is determined that no other electronic payment option can be designed to meet the desired outcomes of a ubiquitous, electronic, end-to-end solution for near-real-time payments, creating a legal framework for EPOs does not seem viable or efficient. If the desired outcome is to continue to reduce check usage, pricing can be an effective tool to change behavior. Alternatively, working toward a ubiquitous, truly electronic end-to-end solution will help serve business needs and a near-real-time solution will address consumer needs. These actions, coupled with changing demographics, will encourage the natural decline in check volume without substantial investments in an outdated payment method.

Q8. Near-Real-Time Payments Effect on Today's Fraud Issues
Near-real-time payments could potentially expedite fraudulent payments which could result in increased losses. Financial institutions and payment system participants will have to take appropriate steps to mitigate these losses. Consumer and business education/awareness will be important in managing these risks. Credit payments or debits with confirmation/authorization would help mitigate fraud risks.

Q8.i. New Fraud Risks
There will always be new fraud risks. Criminals and careless behavior create fraud risks not payment systems.

Q9. Pivotal Change to Mobile Payments
Ubiquity and near-real-time payments will have a tremendous impact on mobile payments, particularly in the P2P and P2B space. Current systems are generally proprietary, requiring time-consuming or cumbersome registration/enrollment processes. NACHA has developed rules to support ACH WEB credits, but this solution is not well suited to the fast and free expectations of the digital age. The importance of mobile payments security must not be overlooked.

Q10. Implications of No Action
If the reference to "the industry" refers to financial institutions and supporting organizations, the implications of not taking action to implement faster payments is significant, and could result in financial institutions becoming disenfranchised. Others will find a way to support faster payments if financial institutions do not. There is consensus that faster payments are necessary; the question is not if, but how to implement. The sooner a clear path is determined, the sooner the industry will move in this direction.

Q10.i. Costs
The costs of not implementing faster payments are a decline in the customer base, fewer DDA accounts and a reduction in revenue. Without the investment in faster payments financial institutions will lose their franchise.

Q11. Modernize Core Processing/Backend Systems
It is possible that some modifications that would improve the speed of payments could be made with incremental changes to processing and systems. Near-real-time payments, with confirmation of good funds and timely notification of payments, ideally integrating the identified payment system into the DDA system, would require massive, expensive changes.

If the Federal Reserve Banks developed a single platform for wires and ACH, financial institutions would have to modify their back-end systems which would be costly, but in the long run would significantly reduce expenses for financial institutions.

Q11.i. Timeframe for Modernization
Changes to core processing and back-end systems do not happen quickly. Without a clear vision and direction these changes will not be undertaken. We reiterate that the Federal Reserve Banks must take a leadership role.

Q12. Centralized Account Number/Routing Directory
The directory concept is interesting and there are small scale models which suggest that directories can work. However, none of the current directories reach all DDAs at all financial institutions. The obvious merits of the directory concept are that the sender would not need to know the account number or routing information of the receiver. The drawbacks are maintaining such a directory and securing the data. Using phone numbers or email addresses has been suggested but identifiers can and do change; and one consumer or business may have multiple accounts, but only one email address or phone number. Unique identifiers have also been suggested, which could accommodate the needs of a single customer with multiple accounts, but this suggestion appears to simply renumber existing accounts. One outstanding question is: Who would be responsible for assuring the accuracy of the information linked to an account? The greatest concern is: At what point does the new routing information become a gateway for

criminals to access the account? The directory, if breached, could result in fraud loses that would make any credit/debit card losses experienced to date pale in significance.

A credit payment model with debit blocks on all accounts, not just business accounts, or a real-time payment confirmation/authorization methodology may be preferable and less risky than a centralized directory.

Q13. Moving Away from Checks

As noted in our response to question seven, faster payments with the attributes identified in the Public Consultation Paper will accelerate the adoption of electronic payments. Until a faster payment system is designed, developed and established it is premature to set target dates to move noncash payments to electronic means. Check 21, which was backed by legislation, resulted in migration of checks to image exchange in a relatively short timeframe without any stated targets.

Q14. B2B Payments/Consumer Bill Payments

Businesses need true end-to-end processing before there will be a wholesale move to electronic payments. Working with providers of accounting packages could prove beneficial in encouraging adoption of straight-through-processing. Retailers would benefit from more aggressive processing and settlement schedules that include weekends.

Consumer education could help consumers that are resistant to change become more comfortable with electronic bill payments. We do not believe electronic bill payment is a concern for the new generation of bank customers, many of whom don’t have or use checks.

Q15. Broader Adoption of the XML-based ISO 20022

In view of the ever-expanding global economy broader adoption of the ISO 20022 message standard seems to make sense; however, based on input from the EPCOR membership, cross-border payments do not appear to be a high priority. If it can be validated that adopting the ISO 20022 would facilitate end-to-end electronic payments and processing for businesses in the U.S. and abroad, this becomes a strategic priority.

Q16. Consumers & Businesses have Greater Choice in Making Cross-Border Payments

Again, we cite limited interest among EPCOR members with respect to cross-border payments. The recent adoption of the CFBP's International Remittance Rule has resulted in many DFIs limiting or exiting the consumer cross-border payments business. Businesses are going to have to make their cross-border payment needs known to their banks before DFIs will be willing to make significant investments in supporting cross-border payments. At the present time, wires and checks remain the dominate cross-border payment instruments. Broader adoption of ACH cross-border payments, with expanded end-points and clarity around destination country rules, would provide consumers and businesses with another choice in making convenient, cost-effective and timely cross-border payments.

Q17. Payment Security

All of the issues identified are important today and will remain important into the future. As mobile payments are more broadly adopted, access device security will become even more important.

Q.17.i. Key Threats
Cyber-attacks, account takeover and careless behavior are key threats today and will remain. The reality is that threats evolve faster than the security to mitigate the threats. Faster payments will increase the speed at which payments can be moved, thus increasing the risks. The Federal Reserve Banks must take the impact of increased fraud and risk into consideration when recommending any solution and take appropriate steps to help payment system participants understand and address these risks.

Q17.ii. Threats Not Adequately Addressed
Low levels of business user security, failed authentication techniques, e.g. tokens and verification schemes, and mobile device security are not being adequately addressed.

Q17.iii. Operational/Technology Changes to Mitigate Cyber Threats
End-to-end encryption and stronger authentication, i.e. biometrics, could be implemented to further mitigate cyber threats. Security professionals will undoubtedly contribute meaningful suggestions to this question.

Q18. Information on Threat Awareness and Incident Response Activities
All financial institutions should have access to a reliable, central repository of information on current and new threats, as well as incident response activities. There is a wealth of security information available from disparate sources, some of which inform on the latest threats only to increase the sale of a mitigating solution.

Businesses need a better understanding of potential risks and threats, as well as their responsibility in managing these risks. Consumers also need to understand the risks and threats without creating a high level of distrust of the system.

Q18.i. Available Information
For financial institutions, databases and alerts are the most reliable information delivery channels. Such information is currently available on a subscription basis, but is not utilized by all DFIs. The Federal Reserve could provide information to financial institutions on new threats via their communication channels.

Businesses and consumers would benefit from increased education delivered by their financial institutions or public authorities. The challenge is to educate without creating fear.

Q19. Future Payment Standards to Improve Payment Security
End-to-end payment encryption and biometric authentication could improve payments security. The challenge will always remain that criminals and technology move faster than the solutions developed to improve payment security.

Q19.i. Obstacles
Cost associated with security enhancements is the most significant obstacle for financial institutions.

Fear of biometrics or other reliable authentication techniques are adoption hurdles for businesses and consumers.

Q20. Fed’s Role to Promote End-To-End Payment Systems Security
The Federal Reserve Banks can further consumer, business and congressional education and awareness, leveraging financial institutions and industry groups as appropriate. While consumers and businesses need to understand the threats and their role in enhanced payments security, legislators also need an understanding of the threats so that laws and regulations are realistic and do not over-burden the payment system.

The Federal Reserve Banks could collaborate with existing security-information organizations to broaden the reach to DFIs of information regarding threats and incident response activities, or alternatively build their own systems which would be accessible to all financial institutions.

Requiring increased security measures as a prerequisite to processing payments through the Federal Reserve's Networks is also an option.

Q21. Additional Perspectives on U.S. Payment Systems Improvements
We applaud the Federal Reserve Banks for encouraging this dialogue. The next step must be a clear roadmap to achieving the desired outcomes. Once this roadmap is developed, the Federal Reserve Banks must take a leadership role to assure these outcomes are achieved.

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