The Retail Industry Leaders Association's (RILA)
Response to the Federal Reserve's Public Consultation Paper

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Introduction

The Retail Industry Leaders Association ("RILA")[1] welcomes the opportunity to submit comments on behalf of its members in response to the *Payment System Improvement – Public Consultation Paper* ("Consultation Paper") issued by the Federal Reserve Banks on September 10, 2013. RILA applauds the Federal Reserve's leadership role both in recognizing the need to develop ubiquitous near real-time payment solutions for retail transactions[2] in the United States and in launching an initiative to address this important issue.

Ubiquitous near real-time payment solutions for retail transactions are increasingly popular around the world. Consumers, merchants, and corporate treasury departments have recognized that these solutions can mitigate liquidity and counterparty credit risks as well as shift transactions to more efficient forms of payment, modernize payment infrastructure, cut processing costs, and provide better financial control. Greater market complexity in the United States may limit lessons learned from near real-time solutions abroad, but the technology exists already and approximately a dozen other countries have demonstrated that it is possible to overcome operational challenges.

Examples of near real-time clearance and settlement solutions include the UK's Faster Payment Service that reduced settlement time from three days to a few hours and Mexico's SPEI that clears transactions every 20-30 seconds during business hours. Australia is developing a new real-time retail payments solution with a December 2016 target date, and Canada is exploring similar options. While several of these existing international systems have "fast batch" clearance and settlement – taking place at several predetermined times during the day rather than truly in real time – even they are useful models because absolute ubiquity and "real-timeness" may not be necessary for every new payment solution in the United States.

Because there is an opportunity cost to the United States lagging far behind the rest of the world in the development of near real-time payment solutions, merchants believe the 10-year timeframe proposed in the Consultation Paper should be accelerated. To be successful, this initiative will require an iterative process – and likely a series of interim steps – facilitated by the government and in which all stakeholder groups have the opportunity for meaningful participation.

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[1] RILA is the trade association of the world's largest and most innovative retail companies. RILA promotes consumer choice and economic freedom through public policy and industry operational excellence. Its members include more than 200 retailers, product manufacturers, and service suppliers, which together account for more than $1.5 trillion in annual sales, millions of American jobs and operate more than 100,000 stores, manufacturing facilities and distribution centers domestically and abroad. Todd Anderson is an outside consultant to RILA.

[2] As well as similarly-sized peer-to-peer and business-to-business transactions.

Merchants stand ready to work constructively and expeditiously with all stakeholders, and look forward to an ongoing dialogue. As a first step in this active participation, RILA recommends adopting the following guiding principles regarding (1) the government's role, (2) governance of new payments solutions, (3) use of legacy infrastructure, and (4) specific requirements for the development of near real-time payment solutions in the United States.

Recommended Guiding Principles

1. <u>Government needs to play a leadership role</u>

Merchants believe it is crucial for the government to play a strong leadership role in the development of near real-time payments. It is rare for merchants to conclude that government involvement in a market is advisable, and even rarer when -- as they are doing now -- they actually request such involvement. Given the U.S. payment industry's history of market failure, however, merchants believe the development of near real-time payment solutions requires the government to serve as an active and impartial leader in this effort. This government role should focus on establishing guiding principles, leaving actual execution to the private sector.

Absent such a government leadership role, merchants are skeptical there will be any near real-time payment solutions in the United States for retail transactions in the foreseeable future. Further, even if such solutions were created without government leadership, the existence of long-standing market failures in the U.S. payments industry likely ensures that those solutions would suffer from the same inappropriate governance that plagues the current U.S. payment system and produces inefficient and inequitable outcomes.

a. Government mandate

One aspect of the government's leadership role should be to establish a mandate for action. As demonstrated with the electronification of checks, industry resistance undermined this effort until the Check Clearing for the 21st Century Act ("Check21") forced banks to take it seriously. Whether motivated by the fear of losing a revenue stream, by an anticompetitive animus, or merely by inertia, issuers' resistance was sufficient to block the electronification of checks until the government mandated action.

The same dynamics exist here with respect to near real-time payments for retail transactions. As discussed below in Section 2(a), media reports indicate that last year large issuers blocked "same day" ACH in order to protect the fee revenue they receive from wire transfers. *See*, *e.g.*, "How Big Banks Killed a Plan to Speed Up Money Transfers," by Kevin Wack, American Banker (Nov. 13, 2013) (a consultant also noted that in the UK regulators had to force banks to implement a near real-time payments system and "that's what will have to happen in the U.S."). Through its actions, this small subset of stakeholders has demonstrated a willingness and ability to undermine progress on an important payments initiative. Due to this and likely resistance from other stakeholders, the government must establish a clear mandate for developing near real-time payment solutions for retail transactions.

In order for the mandate to be effective, however, the government also must establish a roadmap and have effective enforcement authority to drive this initiative forward. By following a concrete timeline and plan for action while holding all stakeholders accountable, the government can lead the industry in developing near real-time payment solutions in the United States.

b. Limited, but multi-faceted government role

Any government role must be well defined and limited in scope. While the precise role may change depending upon the specific task, merchants believe that the issues for which it is most important to have government involvement are governance, guidelines, and facilitating competition.

i. Governance

As detailed below in Section 2, private organizations and companies have proven incapable of providing balanced, equitable, and efficient governance of payment solutions in the United States. Accordingly, one of the government's highest priorities with respect to developing near real-time payment solutions should be to ensure that the governance of each of these solutions is balanced, with all stakeholder groups participating in the decision-making process and the government serving as a neutral leader.

ii. Guidelines

The government also should play an ongoing role both developing and enforcing guidelines. Guidelines are important because they allow the government to help shape the general contours of private sector development (*e.g.*, of near real-time payment solutions), including the establishment of important limits or requirements, while allowing the free market to determine the specific details of products and services within that framework.

iii. Competitive environment

Another important government role is to facilitate competition, new entry, and innovation in the industry. One aspect of this is to remain vigilant in guarding against and, if necessary, breaking down barriers to entry imposed by stakeholders (see Section 4(i)). The government also should ensure that new entrants and innovators (including incumbents) have meaningful access to infrastructure and other essential resources needed to compete in the marketplace. At the same time, the government itself should exercise care to avoid engaging in activities which directly or indirectly stifle competition.

c. Broad input across government agencies

The merchant community recognizes and applauds the Federal Reserve's leadership role in launching this initiative. Complemented by the substantial expertise at the Federal Reserve Board, the constructive role of the Federal Reserve Banks -- including issuing the Consultation Paper and hosting a series of successful "town hall" meetings around the country -- has been particularly valuable. For these reasons, the merchant community believes the continued involvement of the entire Federal Reserve System will be critical to the establishment of near real-time payment systems in the United States.

At the same time, there are other important regulatory bodies that likely will want to be a part of this initiative and could add significant value. The layering of overlapping and sometimes even conflicting regulations by multiple agencies in an uncoordinated fashion, however, would be a particularly inefficient and frustrating outcome for private sector participants. Accordingly, the best approach here may be to involve all of the relevant agencies from the beginning. This could be accomplished by assigning a single inter-agency body to speak and act for government regulators in this initiative.

For example, an existing government body like the Federal Financial Institutions Examination Council ("FFIEC")[3] that has an established structure for, and track record of, agency cooperation may be well positioned to assume the government leadership role for this initiative quickly and effectively. Obviously, the merchant community recognizes that government regulators themselves may identify even better candidates to be the inter-agency body leading the development of near real-time payment solutions in the United States.

2. <u>Must be balanced governance of each near real-time payment solution</u>

Merchants agree with the Federal Reserve's conclusion that this initiative must accommodate the preferences and "meet the needs of *end users* who are the ultimate beneficiaries of the payment system [and that] their needs should drive" the development of near real-time payment solutions. Consultation Paper at 2 (emphasis in original). End users – merchants and their customers – would welcome this change from past decades in which payment card networks and other aspects of the U.S. payment system were created and governed to benefit a small subset of other stakeholders at the expense of end users.

[3] The FFIEC is a formal inter-agency body whose members include the Federal Reserve, Federal Deposit Insurance Corporation, National Credit Union Administration, Office of the Comptroller of the Currency, Consumer Financial Protection Bureau, and the State Liaison Committee that represents state regulators. Despite the breadth of FFIEC's membership, for purposes of this initiative it could benefit from the addition of the FTC, an agency with a consumer-oriented mission that has formal regulatory responsibilities under the Durbin Amendment and also has been focused on privacy issues and other aspects of the U.S. payments system.

a. Existing governance structures are unacceptable

For years, biased governance has imposed inequities on end users and produced inefficient results for society as a whole. Beyond payment card network rules that are openly and directly controlled by a small set of stakeholders for their own benefit, there are private organizations who profess to speak for the entire industry but in reality engage in the same inappropriate governance. Accordingly, these private organizations should not be involved in the governance of any aspect of near real-time payments solutions.

Examples of these private organizations whose governance is designed to benefit the narrow interests of a small set of stakeholders include NACHA, EMVCo, and the PCI Security Standards Council:

- NACHA governs the ACH payment network through the NACHA operating rules, and is controlled by issuers (31 financial institutions and 17 regional payments associations that represent the views of financial institutions in specific geographic areas). Far from balanced, this narrow governance structure caters to only one small set of stakeholders, as illustrated last year when the large banks controlling NACHA rejected a plan to develop even a watered-down near real-time payment solution for retail transactions. *See*, *e.g.*, "How Big Banks Killed a Plan to Speed Up Money Transfers," by Kevin Wack, American Banker (Nov. 13, 2013). Reportedly, NACHA's denial of faster payments (that would have benefited end users) was motivated by the desire to protect large issuers' wire transfer fees.
- EMVCo establishes rules and specifications to govern chip-based payment card transactions in the United States. EMVCo is owned and controlled by six networks (American Express, Discover, JCB, MasterCard, China UnionPay, and Visa) whose representatives comprise the Board of Managers. This is another example of a narrow governance structure that serves the interests of only this small subset of stakeholders. Over the past couple of years, these networks have used EMVCo to impose rules that have been vigorously criticized and opposed by a broad range of other stakeholders.
- The PCI Security Standards Council establishes data security standards for payment card transactions. The PCI Security Standards Council was founded by five networks (American Express, Discover Financial Services, JCB International, MasterCard Worldwide, and Visa) who have agreed to incorporate the PCI data security standards as the technical requirements of each of their data security compliance programs. PCI Security Standards Council is led by a policy-setting Executive Committee composed of representatives of these five networks. Again, this is a narrow governance structure designed to benefit this small subset of stakeholders at the expense of the rest of the industry. As discussed in more detail in Section 4(j), below, the PCI Security Standards Council's decisions and the networks' use of its requirements to shift liability to other stakeholders is an unacceptable model for governance.

Some of these private organizations are quick to catalog their industry outreach efforts, but inviting other stakeholders to join merely "advisory" panels and committees does not constitute meaningful participation. The narrow set of networks and issuers identified above maintain firm control over the decision-making of these organizations. As such, they are able to impose a wide range of (sometime seemingly obscure) rules and take actions that are in their own financial self-interest notwithstanding inequitable or inefficient results for the broader industry. Despite a superficial veneer of inclusion, in truth the governance of some of these private organizations is designed to benefit a small subset of stakeholders at the expense of end users and other stakeholders. Such biased governance is inappropriate for the payments industry generally and particularly so with respect to this initiative.

b. Governance of each near real-time payment solution must be balanced

The government should ensure that all stakeholder groups, including but not limited to end users, have the opportunity to participate in the governance of each near real-time payment solution. It is also important to have a transparent and fair decision-making process because these stakeholder groups will not reach consensus on every issue. In fact, on occasion major disagreements that prove particularly challenging will require a neutral party like the government to take a leadership role to facilitate resolution.

Such balanced governance of near real-time payment solutions should produce results that are more equitable, more durable (absent distrust from stakeholders), and more efficient (with self-interest of one narrow set of stakeholders less likely to be able to prevent conduct that benefits society as a whole). Balanced governance also should address all key issues rather than ignoring areas of legitimate concern to certain stakeholders (*e.g.*, processors may raise issues important to them that other stakeholders would not even address).

For these reasons, balanced governance must be one of the government's highest priorities with respect to developing near real-time payment solutions. The narrow and flawed governance structures of both the dominant payment card networks and organizations like NACHA, EMVCo, and the PCI Security Standards Council should not be utilized or even used as a model; they are unacceptable.

3. <u>Inappropriate to use legacy infrastructure "as is"</u>

Merchants believe the United States ultimately will have to develop entirely new near real-time payment solutions for retail transactions. It would be inappropriate, however, to base such solutions on legacy forms of payment – including the credit and debit card networks, the wire transfer system, and ACH – as they currently operate.

ACH is a good example of legacy infrastructure that has positive attributes, but has such severe limitations in its current form that it would be inappropriate to use as a basis for near real-time payment solutions. On the positive side, ACH has connections to practically all banks and credit unions, and historically has had relatively low pricing. As described immediately above, however, like all legacy forms of payment the ACH governance structure is biased and unacceptable. Among other things, the small number of issuers that control NACHA rules could impose higher and additional fees to convert ACH from a relatively low-cost form of payment to a high-cost one. These issuers also have demonstrated their willingness and ability to block even "same day" ACH, let alone a real-time or near real-time payment solution. Additionally, ACH currently does not validate accounts or fund availability, and lacks finality because of it use of a lengthy, open-ended dispute process. For these reasons, ACH in its current form cannot be used to develop a near real-time payment solution.

Like ACH, all other legacy forms of payment in the marketplace lack acceptable governance and have additional disqualifying limitations as they currently operate. As an interim step prior to the establishment of new near real-time payment solutions, it may be possible to improve some legacy infrastructure by implementing changes that benefit all stakeholders. New, near real-time payment solutions also may end up borrowing limited parts of existing forms of payment. Any such improvements and replication, however, must take into account the severe limitations of legacy infrastructure in its current form and avoid perpetuating any of these fatal flaws.

4. <u>Development of near real-time payment solutions should satisfy the following specific requirements:</u>

    a. Require competitive market pricing

Every day, merchants willingly pay vendors competitive market prices for the products and services needed to operate their retail businesses. Merchants recognize that these competitive market prices their vendors charge represent both the marginal cost of producing these goods and services as well as what economists refer to as a "normal" profit for the vendors, which is the profit a provider receives on a sale of its goods or services in a competitive market.

Merchants are willing to pay competitive market prices for payment services, as well. They expect providers of those services to earn a profit, but it should be a "normal" profit. This would stand in contrast to the broken payments market during the past decades in which providers have used market power and collusion to extract much higher profits from merchants. Such an anticompetitive result has been both inequitable for end-users like merchants and consumers as well as an inefficient economic outcome overall, resulting in what economists call a loss in social surplus. Among other things, this has translated into less secure, more fraud-prone payment solutions than would have resulted in a competitive market.

The federal government should require any near real-time payments solution to have pricing reflecting a competitive market outcome. This would allow providers of the payment solutions to recover their actual costs plus a "normal" profit, but would require those providers to bear the burden of demonstrating that their pricing satisfies this requirement. Because this competitive market pricing would represent a change from what has been typical in the payments industry for decades, the federal government will need to play an ongoing monitoring role to verify that this requirement of competitive market pricing is being satisfied. Moreover, the government needs to establish an effective enforcement regime to punish any circumvention (or attempted circumvention) of this requirement and to deter other solution providers from engaging in similar conduct.

b. Ensure that the costs of operating any such solution are minimized

While such cost-based pricing can create efficient outcomes that are equitable for all stakeholders, it could create incentives for the near real-time payment solution providers to inflate their costs artificially in order to justify higher profits on a larger set of costs. The dispute regarding inappropriate costs in the Durbin Amendment rulemaking highlights the importance of this issue.

Fortunately, there are payment solutions already in the marketplace that provide general guidance regarding the cost of payment solutions. For example, Canada's Interac debit network and other international debit networks are "at par" (meaning no interchange fees are charged), demonstrating that payment solutions can have very low operating costs. Specifically, Interac reports that it "operates on a cost-recovery basis" – similar to the recommended requirement immediately above – and charges merely a switch fee of less than 1 cent per transaction to cover its operating costs. *See* http://www.interac.ca/en/interac-about/interac-fees (the current switch fee "sufficient to cover operating costs" is $0.006534 (Canadian dollars)). A reduced level of fraud in near real-time payment solutions should lower the operating costs for those solutions even further.

Again, the government should ensure that the providers of these new payment solutions do not artificially inflate the marginal costs of providing them (*e.g.*, by using inputs for which there are much less costly but equivalent alternatives or by including other inputs that are not necessary at all).

c. Require that operating rules are neutral and equitable for all stakeholders

As discussed above, these real-time payments solutions must balance the interests of all stakeholders. Neutral operating rules that are equitable for all stakeholders participating in the payments system are a crucial element of achieving such balance.

Unfortunately, U.S. payment solutions during past decades have not had neutral, balanced, or equitable rules. Operating rules of the dominant four-party card networks have been (and continue to be) established by those networks themselves. As you would expect, those rules favor the networks (and the issuers that control those networks) at the expense of end users such as merchants as well as other stakeholders. There have been a large number of litigation, regulatory, and legislative proceedings in recent years detailing the serious and extensive complaints that merchants and other stakeholders have regarding these rules (on issues including, but not limited to, a variety of fees, chargebacks, liability, and steering of retail customers that are embedded throughout the thousands of pages of network rules). While merchants don't believe it is necessary to revisit the details of those disputes here, we would be happy to do so if the Federal Reserve believes it would be helpful. In short, however, these existing network rules – controlled by a small subset of stakeholders – are not neutral and are inequitable to merchants and other stakeholders.

The government should require the operating rules of near real-time payment solutions to be neutral, balanced, and equitable for all stakeholders. By eliminating most of the disruptive (not to mention tremendously expensive and time-consuming) disputes between stakeholders, neutral rules would allow stakeholders to dedicate their limited resources to more productive, pro-consumer initiatives while making the near real-time payment solutions more stable and durable.

d. Allocate fraud and other liability based upon stakeholders' relative ability to prevent it

Requiring the stakeholders that can control fraud to be liable for it would create incentives and accountability absent in the U.S. payment system today. In turn, these incentives and accountability would spur the impacted market participants to take action to reduce fraud that they are not currently incented to take.

Today, there is more fraud in the U.S. payments system than necessary because over the years a small subset of stakeholders – comprised of certain networks and issuers – has imposed a series of rules that perpetuate fraud. One example of this conduct is requiring the continued use of outdated, fraud-prone magnetic stripe technology that other nations, including developing countries, have been phasing out for many years. Another example is the promotion of signature authentication instead of more secure PIN authentication of debit card transactions. This latter example is particularly problematic because in addition to increasing fraud unnecessarily, it has given consumers and other stakeholders a false sense of security regarding the signature authentication.

The resulting unnecessary fraud may be rational from the narrow perspective of this small subset of stakeholders because they have erected a system that shifts liability for most fraud loss onto merchants (even though merchants have no control over the technology or security standards.) From a societal point of view, however, it is wasteful and irresponsible. The result is also grossly unfair to the merchants that are liable for the increased fraud that they are unable to prevent, and ultimately imposes substantial additional unnecessary costs on the end users of the nation's payment system.

Even a previous Chairman of the House Committee on Homeland Security noted that the "payment card industry's effort to shift risk appears to have contributed to our current state of insecurity" and that the major networks appear to be "less interested in substantially improving their product and procedures than the are with reallocating their fraud costs." Statement of Chairman Bennie G. Thompson, *Do the Payment Card Industry Data Standards Reduce Cybercrime?* (March 9, 2009). While undoubtedly profit-maximizing, this selfish conduct by a small subset of stakeholders is irresponsible and unacceptable.

To eliminate such unnecessary fraud in near real-time payment solutions, the government should require that fraud losses and similar liabilities be allocated based upon each stakeholder's relative ability to prevent them. This new approach will create the right incentives among stakeholders, allowing the market to determine the best approach to fraud-prevention. It also will lead to equitable outcomes because those stakeholders able to control fraud will suffer the greatest consequences if they choose not to do so.

e. Ensure that a choice of multiple solutions is available to the end user who pays to use the chosen solution

It is well settled that competition promotes a wide range of beneficial outcomes such as innovation, better service, and lower prices. Competition among payment solutions should be no different, as recognized by Congress in passing the Durbin Amendment that requires merchants to have a choice of networks over which to route their debit transactions.

To ensure the benefits of competition with respect to near real-time payments, the government should require that end users have a choice of solutions for those transactions, as well. The specific solution options may vary across different categories of transactions – ecommerce vs. retail POS vs. peer-to-peer – but there should be a choice of near real-time payment solutions for each transaction. In addition, the end user who is paying for the use of the near real-time payment solution should be entitled to choose which solution to use: if a merchant is going to pay for the solution it should get to choose, and if a customer is going to pay for the solution it should likewise get to choose.

f. Ensure that the true costs of using different payment solutions are transparent to consumers

When customers don't know the relative cost of different forms of payment, inevitably many will choose to use a higher cost form of payment than they would if they had full information. Such unnecessarily costly and inefficient outcomes should be avoided with respect to near real-time payments by ensuring that customers can get the information needed to fully understand the economic consequences of their actions.

For a merchant today, credit cards typically are the most expensive form of payment. Accordingly, merchants would save money (which they could use to offer even better service or lower retail prices) if customers use other, less expensive forms of payment. *See, e.g.,* Shapiro, Robert J., The Costs and Benefits of Half a Loaf: The Economic Effects of Recent Regulations of Debit Card Interchange Fees, http://21353cb4da875d727a1d-ccea4d4b51151ba804c4b0295d8d06a4.r8.cf1.rackcdn.com/SHAPIROreport.pdf. There are many payment network rules, however, that prohibit merchants from steering customers away from using a form of payment like a credit card. As a result, merchants pay much more for payments than is necessary, and ultimately at least a portion of these extra costs gets reflected in lower service and/or higher retail prices paid by customers.

The networks (and issuers who control them) may benefit by blocking these pricing signals to consumers, but society as a whole is worse off. Moreover, the problem is even worse than consumers simply not knowing that they are imposing additional costs on merchants (and ultimately on themselves in the form of higher retail prices to recover some of these additional costs) by choosing to use certain high cost forms of payment. Networks and issuer have created a system in which some consumers are actually "paid" to use these higher cost options in the form of reward programs and other benefits. These reward and benefit programs are funded using some of the extra fees that merchants pay for credit card transactions[4].

Thus, beyond prohibiting merchants from educating consumers about the true costs of different forms of payment, networks and issuers also subsidize the most expensive forms of payment using fees they charge merchants. Again, while this conduct by networks and issuers presumably is profitable for that small subset of stakeholders, it distorts the economic behavior of consumers who receive these subsidies and imposes unnecessary costs on them as well as society as a whole.

To address this market failure, the government should ensure that the true costs of using different near real-time payment solutions are transparent to consumers and undistorted by hidden subsidies that third parties are forced to fund. If reward programs and other benefits are valuable, then the recipients of those benefits – the consumers – should be willing to pay for them on a stand-alone basis. Enticing

[4] Importantly, not everyone benefits from card reward and benefit programs. Because most consumers do not have or even qualify for rewards cards but pay the same price for goods and services (using cash, etc.), they end up subsidizing the typically high-income consumers participating in these card reward and benefit programs. For example, "[o]n average, each cash buyer pays $149 to card users and each card buyer receives $1,133 from cash users every year." Schuh, S., O. Shy, and J. Stavins. 2010. "Who Gains and Who Loses from Credit Card Payments? Theory and Calibrations." Federal Reserve Bank of Boston, Public Policy Discussion Paper 10-03 at 3. As discussed further in Section 4.g., this subsidization of reward programs is a regressive transfer of wealth from low-income consumers to high-income consumers. *Id.*

consumers to participate in such programs with hidden subsidies that merchants and other stakeholders are coerced to fund distorts the marketplace. Ultimately, at least some of these subsidies also represent an actual cost to consumers in the form of higher retail prices or decreased service. Beyond subsidies, if certain forms of payment simply cost merchants more, it would be efficient for each merchant to have the option of trying to steer consumers to another form of payment. Consumers will be free to make their own decisions, but those should be fully informed decisions that take into account the true cost to them and other stakeholders. The key is that the true cost of near real-time payment solutions is transparent to all end users.

g. Avoid regressive impacts on consumers

Forcing merchants either to pay more than competitive market prices for using payment solutions or to subsidize high-cost forms of payment has a regressive impact on consumers. Because retail is an extremely low-margin industry, merchants are forced to offset at least some of these unnecessary costs by raising retail prices or decreasing the service they provide to their customers. These adverse results disproportionately affect lower income consumers.

Indeed, the impact on these lower income consumers is three-fold. First, they are paying higher retail prices (and suffering from reduced service). Second, these consumers typically are un-banked or under-banked with little ability to access the forms of payment – such as credit cards – that offer the rewards programs and other benefits that merchants (and ultimately their customers) are funding. Third, increased retail prices are particularly regressive because lower income consumers spend a disproportionately high percentage of their income on retail goods like food and other necessities.

Near real-time payment solutions should avoid these regressive impacts on consumers. The Federal Reserve's laudable initiative to improve the payments system should take into account equitable concerns as well as efficiency improvements.

h. Remain technology agnostic

As detailed above, we strongly recommend a government role in establishing near real-time payment solutions. That role, however, should be limited primarily to matters of governance and establishing guidelines for private sector market participants. We do not believe it would be appropriate for the government to pick winners and losers with respect to technology.

To the contrary, we believe the most appropriate technology role for government is to ensure that this initiative and the entire U.S. payments system remain agnostic with respect to which technologies are used in near real-time payment solutions. As long as near real-time payment solutions adhere to the government's guiding principles and collectively address the different categories of transactions – such as ecommerce, retail POS, and peer-to-peer – the specific technologies they utilize should be determined by free market forces.

i. Prohibit price collusion, exclusionary conduct, and "hold-up" situations

With respect to near real-time payment solutions, the government should prohibit price collusion, exclusionary conduct, and "hold-up" situations (*e.g.*, through the use of standard essential patents) across the boards without getting bogged down in any antitrust or related legal analysis. There would be no finding of illegality, just a simple prohibition.

This prohibition would facilitate a competitive marketplace for these payment solutions while avoiding the immense drain of resources that for decades has plagued the stakeholders in the payments industry, as well as the courts, regulators, and legislators tasked with refereeing these disputes. These disputes also have distracted the same stakeholders from engaging in pro-competitive activities that could have led to much earlier adoption of innovations like ubiquitous, real-time payment solutions.

The government should enforce this prohibition as a prophylactic measure even though certain stakeholders have well-rehearsed arguments allegedly providing technical justifications for price collusion, exclusionary conduct, and "hold-up" situations that typically constitute illegal conduct. Even if there are narrow circumstances under which such behavior theoretically could survive legal challenge, this conduct is almost always anticompetitive. Moreover, participants in analogous industries – including network industries – are competitive and profitable without engaging in this type of behavior. Under even the best of circumstances, this conduct still creates a high risk of undermining competition, creating economic inefficiencies, artificially inflating prices, and stifling innovation and entry.

Absent such a prohibition, the marketplace for near real-time payment solutions will be subject to a wide range of anticompetitive behavior as well as expensive legal battles among stakeholders that will distract them and regulators from engaging in valuable, pro-competitive activities and delay any progress that could be made. This simple, prophylactic prohibition will avoid an almost certain legal morass that has retarded progress in the payments industry for decades, and will not require the government to engage in any legal analysis or reach any legal conclusions.

j. Identify data security and privacy best practices or standards

Security of payments data is an important topic, and we appreciate the Federal Reserve's sensitivity to the issue. As noted in the Consultation Paper, it is critical to have secure authentication, infrastructure (hardware and software), and transmission of information. A similarly important topic is privacy of transaction data. As observed by regulators at the FTC, both the large number of companies involved in payments transactions and the large volume of data being collected – especially with mobile, ecommerce, and other digital forms of payment – raise significant privacy concerns.

Given the importance of these topics, the identification of best practices or establishment of actual standards would facilitate the development of near real-time payment solutions. Data security and privacy best practices or standards, however, must be balanced and established with active participation from all stakeholder groups.

This balanced approach would stand in stark contrast to the ongoing efforts of a private organization controlled by a small subset of stakeholders that has attempted to impose its own standards on the entire industry. As noted above, the PCI Security Standards Council was established and remains controlled by a small subset of stakeholders, the dominant card payment networks. While merchants have been invited to join certain advisory panels at that private organization, such limited participation does not permit merchants to have any meaningful input into the organization's standards.

Merchants have strongly criticized the data security standards developed by the PCI Security Standards Council as biased in favor of networks and issuers at the expense of merchants and other stakeholders.[5] Indeed, these private standards are another example of the type of conduct referenced in Section 4.d. that has resulted in more fraud in the U.S. payments system than necessary. Yet despite these concerns, the dominant networks and issuers have attempted to establish these private standards controlled by a small subset of stakeholders as the standard of care for data security for all industry participants.

Given this context, it is important for the government to take a leading role in establishing best practices or standards for data security and privacy regarding near real-time payment solutions. These best practices or standards should be developed based upon balanced input from all stakeholder groups, with the government serving as a neutral party.

Protection of consumers and other stakeholders with respect to data security and privacy needs to be effective. To that end, the best practices or standards should avoid practices that provide only a false sense of security (*e.g.*, signature authorization) and should limit use of a purchaser's data (*e.g.*, to counter-parties to the relevant transaction who have received explicit opt-in approval from that consumer). There are likely to be several challenges – for example, even if account

[5] As with the network rules mentioned above, there have been litigation, regulatory, and legislative proceedings in recent years detailing the criticism that merchants and other stakeholders have of these PCI Security Council standards and their use in the compliance programs of the dominant networks. Again, while we don't believe it is necessary to revisit the details of those concerns here, we stand ready to do so if the Federal Reserve believes it would be helpful.

information is masked or tokenized, merchants still need to be able to identify their customers – but merchants are confident that a balanced, inclusive approach can produce appropriate best practices or standards.

Electronification of Paper Checks

The electronification of paper checks in the United States during the past decade is an example of the progress that can be made in the payments system. As noted above, government leadership in that initiative has been effective, even in the face of resistance from financial institutions. Indeed, the maximum value allowed for POP, BOC, and ARC check conversions has been raised to accommodate electronification of an increased percentage of paper check payments.

To be sure, electronification of paper checks remains incomplete. Not all business checks are converted and some small merchants still lack the ability to convert paper checks. Additionally, as the migration from paper checks to electronic forms of payment continues, it is important to ensure that there are sufficient payment options for under-banked consumers.

Achieving complete electronification, however, should not be the highest payments priority. Merchants would not want the remaining steps in electronification to distract from the more crucial focus on developing near real-time payment solutions. Indeed, the most important remaining checking issue is "real-timeness," not electronification, because electronification alone does not address speed of settlement (or at least good funds guarantee) if ACH or other non-real-time payment solutions are being utilized.

Accordingly, merchants applaud the progress made to date with respect to electronification of paper checks and will continue to support that initiative. Currently, however, the development of developing near real-time payment solutions is a higher priority.

Cross-Border Payments

Merchants recognize that ISO 20022 messages are increasingly being adopted in international retail payment solutions, and anticipate providing input regarding cross-border payments as this initiative on near real-time payment solutions moves forward.

Conclusion

Merchants appreciate the Federal Reserve's attention to the important issue of developing near real-time payment solutions in the United States. The Consultation Paper's thoughtful solicitation of industry input has set a constructive tone for what merchants hope will be an expeditious and successful initiative.

As discussed, it is crucial to have an inclusive, balanced process in which all stakeholders groups can have meaningful participation. At the same time, success will require government leadership to establish a mandate for action that includes appropriate governance of these solutions as well as guiding principles and specific requirements that facilitate equitable and efficient market-based outcomes.

Merchants look forward to the government's continued focus on the development of near real-time payment solutions, and welcome ongoing dialogue. The merchant community stands ready to cooperate with other stakeholders on this initiative and move forward expeditiously.