December 13, 2013

By Electronic Delivery to comment@fedpaymentsimprovement.org

Re: Federal Reserve Banks Payment System Improvement – Public Consultation Paper

Ladies and Gentlemen:

In a speech at the Federal Reserve Bank of Kansas City's Jackson Hole conference, Andrew Haldane, of the Bank of England, juxtaposed the difficulties that a physicist encounters in calculating the flight path of a frisbee with a border collie's superior ability to catch the same. He was advocating for simplicity in regulatory policy in the context of financial stability. The dog and frisbee speech recognized that financial markets are complex and operate in ways that analytics and "science" cannot necessarily explain.

The U.S. payment system is similarly complex and myriad factors go into end users' decisions to choose one payment type over another. The rapid evolution of communication technologies adds another dimension to this complexity. Taken together, these characteristics of the U.S. payment system strongly suggest that the future of payments in the United States lies in diversity, flexibility and competition, rather than a single ubiquitous solution, even if that ubiquitous solution is based on a thorough analysis of stake-holder views and interests. Consumer choice and the evolving business requirements of market participants, including large and small retailers, should drive the future of retail payments – not a technical or "scientific" design.

Diversity in the retail payment system is essential. All payments involve certain core components: communication of payment information, transfer of value, and a legal architecture that gives meaning to the transaction and addresses common problems. However, payments between different counterparties (known or unknown, business or consumer), in different amounts, with varying frequency (one-time or recurring), and for different purposes (emergency, discretionary, day-to-day, or paying bills) emphasize different aspects of these core components. In the case of point-of-sale ("POS") payments, the merchant can confidently allow the consumer to leave the store with its merchandise because of the swift communication of payment information and a guarantee that value will be transferred to the merchant. For business-to-business payments, communicating the information that links a particular payment to one or more invoices may be critical. For person-to-person gifts and for informal transactions, such as those that might occur at a farmers' market, the ability to make payments to a broad network of individuals may be critical. The potential variations on which of these core components an end user emphasizes are endless. Moreover, payment system participants, including retailers,

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financial institutions and technology firms, are increasingly investing in payment platforms and devices to support business functions related to payments, such as marketing and loyalty. End users will elect to use different payment methods based on the characteristics of those methods or ancillary services related thereto.

Payment options are limited by a number of practical considerations relating to settlement and the legal architecture. Currency, which combines settlement and legal architecture in a single instrument, is risky and difficult to transport and therefore is not suitable, as an example, for making payment to a geographically remote counterparty. Paper instruments, such as checks, may pose less risk for remote transactions, but are subject to risk of return and are costly to collect and require a separate settlement mechanism. Electronic payment options are growing at a rapid pace in both number and variation, but settlement arrangements for such payments are generally tied to an exchange of bank credit. Moreover, as the legal characteristics of certain electronic payment options are established by networks of agreements, the scope of these arrangements may limit the reach of these networks.

Currently, retail payments, including consumer-to-consumer and consumer-to-business payments, are generally made by cash, check, ACH or payment card. For much of the last 100 years, cash and checks dominated retail payments, aided by Federal Reserve Bank communication or transportation and settlement support. Cash, checks and, more recently, ACH transactions operated as more or less open systems, over which transactions from a host of different check and ACH providers were processed in a consistent and commodity fashion. In the latter part of this period, which coincides roughly with the development of the ACH system, private payment card networks have developed and become popular. These systems are structured around private agreements and, therefore, operate as closed systems, although they have become so pervasive that many consumer-to-business transactions can be conducted through multiple systems. Unlike the legacy cash, check and ACH systems, it is important to note that the processing in support of these private payment networks was built in increasingly differentiated ways, albeit with a focus on interoperability where required by the marketplace. In recent years, these networks made, and continue to make, considerable differentiated investments in processing to innovate on various aspects of network processing functionality as the needs of end users have evolved, migrating away from the historical notions of common utilities for cash, check and ACH processing.

The Federal Reserve Banks' Payment System Improvement Public Consultation Paper (the "Consultation Paper") raises the question of whether retail payment services are evolving in a way that will meet the needs of consumers and businesses. The Consultation Paper also raises the question of whether the Federal Reserve System should play a role in facilitating that evolution, and if so, in what capacity. Visa has extensive experience in identifying, anticipating and meeting consumer, retailer and other business demand for payment services, and welcomes

the opportunity to share our views on these and other questions raised in the Consultation Paper. Visa will focus its comments primarily on the area of retail payments that it knows best:

- First, Visa believes that for the most common payment types, consumers and businesses have multiple choices for highly efficient and secure payments. That is, **most retail payment needs are well served by current and emerging payment services**. Although some end users – consumers and businesses, alike – may prefer that these payments were made available at a lower price, that end-user preference is not surprising and is not limited to payments. Indeed, the desire to pay less is probably true for virtually all goods and services.

- Second, Visa believes that **market-based innovation is thriving and will continue to meet most end-user needs, as private systems expand and extend their scope,** and that any perceived problems in the U.S. payment system should be addressed in a targeted way and only with a full understanding of the likely benefits, costs and consequences to all participants in the payment system, as well as the trajectory of the industry, more broadly.

- Third, Visa believes that others may perceive problems with certain classes of payments that the private sector has not yet addressed. It may be appropriate for the Federal Reserve Banks to consider whether enhancement to their existing services or the introduction of new services would be appropriate under Federal Reserve policies for pricing, and whether new services or service enhancements can address these perceived problems. In this regard, Visa believes that **the Federal Reserve System should focus on enhancing the Federal Reserve Banks' payment services, rather than changing the way in which private-sector payment systems operate.**

- Finally, **the Federal Reserve should continue to act as a facilitator of discussion of payment issues and help to remove obstacles to necessary improvements in and expansion of private sector payments,** as it did in promoting the Check 21 legislation.

Most Retail Payment Needs are Well Served by Current and Emerging Payment Services

While Visa is only one of the private payment networks, we believe that Visa's experience provides a useful example of how current retail payment needs are being met. We are confident that other networks will, or can, provide similar examples.

Visa and the other public and private payment networks are part of a diverse, complex and thriving retail payment system that helps drive the global economy. Growth in the use of electronic payment products, such as credit and debit cards, added an estimated total of

$983 billion to the Gross Domestic Product (GDP) of 56 countries between 2008 and 2012.[1] During the same period in the U.S., increased card usage added $127 billion to the U.S. economy.[2]

Visa itself is a global provider of payment services connecting consumers, businesses, banks, and governments in more than 200 countries and territories worldwide. Visa has a network of 14,600 financial institutions, which have issued 2.2 billion Visa cards that are accepted at tens of millions of locations. In the year ending September 2013, VisaNet processed more than 85 billion Visa and non-Visa transactions, with $6.9 trillion total volume ($4.3 trillion payments volume). VisaNet handles an average of 150 million transactions every day, and we estimate that VisaNet is capable of processing more than 47,000 transaction messages per second.

Visa's product assortment enables consumers and business customers to choose how they want to make payments: pay now with Visa debit products, pay ahead with Visa prepaid products, or pay later with Visa credit products. Regardless of the customer's chosen payment method, merchants receive guaranteed payment. VisaNet authorizes and clears ATM transactions as a single message that provides Visa cardholders with access to cash globally in local currency from their bank accounts. VisaNet also enables merchants and financial institutions to receive immediate risk information, and issuers to provide cardholders with real-time information-based services, including transaction alerts for cardholders that sign up for the service. Visa and other private payment networks reach almost all retail payment system users, and emerging networks are partnering with various technologies to improve the reach of their networks. Where payment card networks are not available – or even where payment card networks are an available alternative – the ACH networks enable payments to or from any bank account in the United States. Visa and other payment service providers work to promote financial inclusion and to provide simple, reliable and secure payment services to the billions of under- and non-banked around the world. Visa has 19 years of 100 percent reliability during peak season.

Existing private networks and service providers continue to improve and expand their services, and compete on the basis of those improvements and services. The current payment networks are both pro-consumer and pro-merchant: typically providing zero liability, clear chargeback and arbitration rights to resolve exception transactions and major events, and guaranteed payment. Visa also continues to improve real-time information flows to merchants and cardholders: merchants receive authorization messages almost immediately notifying them

[1] *See* Moody's Analytics "The Impact of Electronic Payments on Economic Growth" (February 2013), http://corporate.visa.com/_media/moodys-economy-white-paper.pdf.
[2] *Id.*

of good funds and providing them guarantee of payment, and cardholders can elect to receive real-time transaction alerts when a purchase has been made. Thus, transaction authorization and the availability of information concerning the transaction are available to merchants and consumers in real time. The timing of clearing and settlement continues to improve, as well. Today, VisaNet clears many debit and ATM transactions real-time automatically once the transaction has been authorized, more than half of all debit transactions by the next day, and 90 percent of all debit transactions by the second day.

These real-time or near-real-time payments are accomplished securely and with minimal fraud losses. Private networks and service providers have invested heavily in security and fraud prevention. Today, less than 6 cents out of every $100 transacted over the Visa network globally are lost due to fraud. As an industry leader, Visa has made significant enhancements to the Visa network in order to reduce fraud losses to this level. Such enhancements include 24/7/365 monitoring against fraud and cyber threats; developing payment card industry data security standards ("PCI DSS") to protect cardholder data security; developing EMV contact and contactless chip technology; developing an end-to-end encryption solution; and fraud prevention tools such as alerts and real-time advanced authorization tools, which enable cardholders to confidently engage in electronic payments. Recently, the payment card networks introduced a proposed framework on a global standard to tokenize card account numbers for online and mobile transactions and eliminate the consumer need to enter actual account numbers. Restricting access to card account numbers represents but one of the payment card networks' efforts to fight fraud and improve the security of the payment system.

Visa has also recently announced enhancements to its Advanced Authorization technology to provide more transactional data history and access to neural networks to analyze that data for authorization decisions in real time. The enhancements promise to boost detection of fraud in debit and credit transactions, perhaps by as much as 130 percent and 175 percent, respectively. These improvements should substantially reduce fraud in both card-present and card-not-present transactions, while ensuring legitimate transactions are handled with the speed and convenience desired by end users.

In sum, most of the retail payment needs identified in the Consultation Paper are being addressed or are being evaluated by retail payment providers, in response to market demand. Visa and other payment providers are continually innovating and enhancing their payment services to meet this demand and provide consumers and businesses with a variety of choices for highly efficient and secure payments. Speeding up settlement for the sake of faster settlement – if other countries' experiences with faster payments are any indicator – will come at the price of such innovation and potentially distort incentives toward less optimal investments that may not meet the needs of end users as a whole. We would also caution against facile comparisons to other countries, where market dynamics may be far less robust and heavier government

involvement in market and competition is the norm. Indeed, a more holistic comparison, including factors such as innovation, efficiency, flexibility, reaction to rapidly changing markets and circumstances, and diversity of solutions and market participants, among other factors, may indicate that any suggested "gap" would actually tilt strongly in favor of existing U.S. payment options.

Market-Based Innovation Will Continue to Meet Most End-User Needs

The U.S. payment system is in a period of rapid innovation and widespread change spurred, in large part, by advances in technology and communications. A large number of new payment service providers have emerged in the market to provide payment services in new ways through new and traditional channels. For example, mobile network operators such as AT&T and Verizon, handset manufacturers Samsung and Motorola, and e-commerce giants Amazon and Google have all introduced payment-related services capitalizing on their respective existing platforms. In addition, a bevy of new payments startups buoyed by $1.9 billion in venture capital investments from 2010 to 2012 are targeting new innovations that will shape the payments landscape of the future. As POS terminals become increasingly Internet enabled and connected, and mobile devices expand and grow their functionality, new innovations become increasingly easier to deploy and update. Square, for example, and other similar payment service providers, have seen explosive growth through mobile devices matched with simplified and powerful software.

Increasingly, mobile devices can be used to make payments directly at a physical point of sale or remotely on the device itself. Mobile payments have the potential to increase consumer choice even further by providing additional channels to pay and the ability to deliver additional information, including merchant offers, loyalty rewards and transaction histories, to consumers through digital wallet applications. In addition, smartphone and tablet-based applications are allowing merchants of all sizes to accept payment in more retail environments. This innovation is taking place in response to identified use cases and consumer and merchant demand. Meaningful innovation is also taking place in cyber security and fraud prevention.

While the Consultation Paper points out that opportunities for improvement and electronification remain, market participants are actively competing to address these opportunities, including developing new ways for payment cards to be used to reach payees that do not accept payment card payments. For example, Visa has developed bill-payment services to enable Visa cardholders to pay merchants that may not otherwise accept card payments (e.g., landlords and utility billers). Similarly, Visa has developed prepaid services to enable government agencies and corporate treasuries to significantly reduce check disbursements for benefits and payroll needs, respectively. In the consumer-to-consumer space, Visa Personal Payments allows consumers to make payment to Visa cardholders anywhere in the world using original credit transactions that authorize and clear in real time at a significantly lower cost

compared to wire, ACH, or money transmitter options. Visa is also developing commercial prepaid services to facilitate straight-through processing of invoices and payments, and making more payment and invoicing information available to payers to enable more efficient reconcilement. While it is unlikely that all check or cash payments will be replaced by electronic payments, based in part on products and services similar to those listed above, the volume and reach of electronic payments promises to continue to increase.

These initiatives also illustrate that the private sector is identifying and addressing end-user demands for more efficient payment services with enhanced features – and there are countless other initiatives underway in the market – where there is an identified demand. The existence of multiple "closed" networks spurs competition and provides end users choices that would not be available in a monolithic, ubiquitous system or central utility. Visa strongly believes that, in the United States, private payment systems arose because they were able to more effectively identify and respond to end-user demands, and do so in efficient and differentiated ways, when compared with the ubiquitous, open legacy systems for check and ACH.

Competition in the U.S. payment system – including competition between and among private-sector market participants and the Federal Reserve Banks – is key to ensuring improvements in the U.S. payment system.

However, the competition and innovation described above also bring new challenges. Non-traditional payment service providers have assumed an important and growing role in the U.S. payment system. These providers perform many functions in the payment system, some of which were traditionally performed by financial institutions. These new entrants may bring new risks to the payment system. For example, payment aggregators frequently mask the identity of the ultimate payee in payment messages that they originate. This practice can make it more difficult for account-holding financial institutions to identify fraudulent transactions and for accountholders to identify unauthorized transactions.

Many non-traditional payment service providers also escape the rigorous examination process that applies to financial institutions and their service providers. The supervisory regime to which financial institutions are subject promotes a safer and more secure payment system. Non-traditional payment service providers should be subject to a comparable regime.

The Federal Reserve System Should Focus on Enhancing its own Services and on Targeted Initiatives to Remove Obstacles to Payment System Improvement

Regardless of private-sector innovation, Visa recognizes the importance of the Federal Reserve System's role in retail payments, including as a payment service provider. Depository institutions that issue Visa payment cards or acquire Visa transactions in the U.S. use Federal Reserve payment services to settle their Visa transactions. The Federal Reserve Banks, and the

Federal Reserve System more broadly, have played – and continue to play – a critical role in U.S. payment system improvement.

As payment service providers, the Federal Reserve Banks compete with private-sector providers for interbank payments, subject to established cost recovery principles. In effect, the Federal Reserve Banks' presence in the market establishes a floor that the private sector must exceed. While administering a number of statutes that govern payments activity, the Board of Governors of the Federal Reserve System ("Federal Reserve Board") has promoted statutory and regulatory changes to further improve payments where the market itself may not have adequately responded. The Federal Reserve Banks have supported these initiatives through their own services, provided technical expertise and (where statutory or regulatory changes are not required) implemented payment improvements on their own initiative. Par clearance and provisional settlement on the day of presentment for checks, Fedwire, Fed ACH, direct check return, and debit image processing are evidence of Federal Reserve payments services leadership. Similarly, the Federal Reserve Banks have introduced a same-day ACH settlement service – and recently proposed rules to promote use of the same-day ACH settlement service across operators – and now offer a remittance transfer product to facilitate cross-border payments.

Visa believes that, going forward, the Federal Reserve System should continue to make contributions to retail payments in four important ways:

First, the Federal Reserve Banks should continue to improve their existing services and consider new services, consistent with existing Federal Reserve policies. Enhancing and extending existing services will continue to raise the bar for private-sector payment providers and spur innovation in the private sector; however, new services and service enhancements should only be undertaken where, consistent with current Federal Reserve policies, the Federal Reserve expects that its providing the service will yield a clear public benefit and where other service providers alone cannot be expected to provide the service with reasonable effectiveness, scope, and equity. For the reasons noted above, Visa believes that the current environment of rapid innovation and wide spread change spurred, in large part, by advances in technology and communications, makes it difficult to conclude that there is a public need that the private sector cannot be expected to meet.

Second, the Federal Reserve should continue to serve as a facilitator of discussions about the U.S. payment system and of more proactive initiatives, as it has with the Consultation Paper. This process will continue to call attention to payment system issues.

Third, the Federal Reserve should continue to serve as a resource for other regulators, such as the Bureau of Consumer Financial Protection, that have jurisdiction over non-traditional payment service providers.

Fourth, where legal or other obstacles are holding back critical payment systems improvements, the Federal Reserve should exercise its regulatory powers or seek legislation necessary to remove the impediment. This is a call for restraint, not a call for action. The Federal Reserve's focus should be on removing obstacles to innovation rather than mandating changes to existing services or investment into new systems or infrastructure where existing incentives are already sufficient. It should focus on critical needs in the broader economy.

For example, par clearance addressed a significant safety and soundness issue for banks in the form of cash items in the process of collection, which represented a large asset of uncertain value until check clearing was made more efficient. Par clearance also involved a prolonged battle between competing economic interests that has not been fully resolved to this day. Disparities continue to exist in the rights to payment for checks on the day of presentment. In contrast, Check 21 removed the impediment of anachronistic state laws that prevented electronic collection of checks and thereby removed the reliance on the physical transportation of checks to achieve interbank settlements—reliance that September 11, 2001 demonstrated to be fragile. Check 21 opened the door to electronic check collection services with minimal adverse impact on existing payment system participants. Check 21 is a model for approaching payment issues, one that opens doors rather than mandating changes.

Focusing Federal Reserve efforts on a single objective or a few objectives runs a significant risk of distorting incentives in the payment system and eroding, rather than improving, payment services. For example, taking the view that payments are a low-value utility, without regard to impacts on consumers, competition or innovation investment, would inevitably reduce innovation and security in, and the integrity of, the U.S. payment system.

The Consultation Paper posits a number of ways to achieve desired outcomes that appear to be inconsistent with the approach of removing impediments to competition. For example, question 6(b) in the Consultation Paper raises the possibility of linking together existing limited participation networks so that a sender in one network can make a payment to a receiver in another network, while question 6(d) raises the possibility of enhancing the debit card networks to enable ubiquitous near-real-time payments. Although debit card transactions are frequently used to fund other payment transactions, such as ACH credit transactions or check transactions offered by bill payment or money transmitter services, these alternatives for achieving desired outcomes could be read to require some sort of universal processing of debit card transactions over different networks or transaction flows between networks so that cards might be used for transactions over networks that are not identified or enabled by the card, or that networks might somehow send transactions to each other. Without further details, it is only possible to provide high-level comments on these two questions; however, it seems clear that these are not viable options for improving retail payments.

First, such a change would entail significant legal and operational changes, and we are not aware of any such authority vested in the Federal Reserve Banks or the Federal Reserve Board for requiring such changes. The operating requirements for debit card transactions are defined by each network's rules or agreements. The terms of these rules or agreements differ. Processing transactions on more than one network would require a standardization of the terms, including settlement, data formats and dispute rules for these transactions that, as a practical matter, would require federal legislation and operationally would be a very significant and costly undertaking for the industry.

More fundamentally, imposing any such requirement would put an end to network competition and unique network services and likely to network innovation in services, data security and fraud prevention, described in detail above. Networks would no longer be able to distinguish their brands on these bases, and therefore they would have little incentive to invest in new services, security or technology as most types of network differentiation would essentially be foreclosed. For example, if a transaction was associated with Visa because it took place with a Visa-branded card but, unbeknownst to the cardholder, was handled by another network, Visa would be subject to reputational risk for the transaction for fraud, operational and other problems, but would have no effective way to address that risk. Finally, any such requirement would limit consumer choice of payment methods.

Visa data shows that the current environment of network competition has led to debit and credit card payments comprising more than 50 percent of the value and the number of payments made by its cardholders over the age of 18, an increase of more than 100 percent since 1997. Any attempt to restructure this market is likely to result in a reduction in the availability and quality of payment services rather than an improvement in payment services. In this regard, Visa joins the Federal Reserve Banks in pursuit of improvements to the payment system.

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