

**American Bankers Association Comments on the
Federal Reserve Banks’
Payment System Improvement Public Consultation Paper
December 13, 2013**

The American Bankers Association (ABA)¹ is pleased to submit comments on the Payment System Improvement Public Consultation Paper (Consultation Paper) published on September 10, 2013.² The Consultation Paper articulates the Federal Reserve Banks’ perspective on key gaps and opportunities in the payment environment as well as outlines desired outcomes that would close those gaps. Payments industry participants are asked to submit comments on several issues, including the perspectives described in the Consultation Paper, the potential strategies and tactics to shape the future of the payments in the United States, and the appropriate role of the Federal Reserve Banks in the effort to improve the payment system.

As noted by the Consultation Paper’s abstract, “The U.S. Payment system is undergoing a remarkable period of change, driven by rapid adoption of technology and evolving end-user expectations.” We strongly agree with the need to provide product choice within the payment system to match customer expectations. ABA supports aggressive efforts to improve the payment system that satisfy all of the following attributes:

1. Develops a payment product that is ubiquitous, private, and settles in near-real-time (UPNRT)³ as part of a diverse set of payment choices at competitive market prices responsive to varied customer needs.
2. Maintains system integrity by providing (a) leading security solutions; (b) efficient and reliable execution of transactions; and (c) compliance with antifraud controls, financial crimes reporting requirements and sanctions-screening obligations.
3. Ensures application of consumer protections appropriate for new payment functionality and enforces regulatory oversight consistently to bank and non-bank payment providers.
4. Enables banks of all sizes to deliver the latest payment functionality to their customers at terms that are competitive in the payment system marketplace.

¹ The American Bankers Association represents banks of all sizes and charters and is the voice for the nation’s \$14 trillion banking industry and its two million employees. Learn more at www.aba.com.

² Payment System Improvement Public Consultation Paper, Federal Reserve Financial Services, September 10, 2013, http://fedpaymentsimprovement.org/wp-content/uploads/2013/09/Payment_System_Improvement-Public_Consultation_Paper.pdf

³ Ubiquitous—readily available to all participants; private—does not require payer’s knowledge of payee’s account credentials.

Gaps and Opportunities

The Consultation Paper is predicated on a “gap and opportunity analysis of the payment environment” that the Federal Reserve characterizes as “comparable to the results of a similar gap analysis conducted in 2002.” In ABA’s view, that this should be the case demonstrates both the resilience of the legacy payment system and the elusiveness of a viable market for electronic real-time payments. It also illustrates the shortcomings of the analysis by not identifying significant developments in the intervening decade that will have material impacts on pursuing the aspirations for our future payment system.

ABA generally concurs with the Gaps and Opportunities identified in the Consultation Paper; but we believe that important additional observations should be recognized.

Foundational Observations—legacy system resilience

The fundamental observation of the analysis is that “Legacy payment systems tend to be more ubiquitous, making them efficient and accessible for those who already maintain a transaction account with their bank.” This is buttressed by the corollary observation that “check writing persists because checks have important attributes, including ubiquity and convenience, which are not well replicated by electronic alternatives for some transactions.” What is implicit in these observations is the significance of the banking industry as the backbone of our existing efficient and effective payment system and the related importance of participation in the banking sector in order to derive the maximum utility from that system.

Transformative Observation—mobile devices

The observation that captures the impetus for transforming and finally achieving advancement of the payment system to UPNRT is the proliferation of mobile devices in daily commercial and interpersonal relations. In the past decade, the evolution of mobile communications from voice to data and the broad access to these devices by individuals from all walks of life provides the practical means for delivering virtually universal cashless exchange across all economic actors willing to acquire a connected mobile device.

Market Observations—transitional challenges

The other observations of the analysis are basically reflections of the market realities that characterize the challenges of transitioning from the current payment system to the future one: international adoption compelled by government intervention; incipient expressions of user demand for electronic payment utility; perceptions of under-performance of cross-border payments; business sector investment in existing payments infrastructure compared with the complexity and costs of re-inventing that infrastructure to support future payment capabilities; and consumer fear of a lack of electronic payment security.

Important Supplemental Observations

ABA believes that the Consultative Paper’s Gap and Opportunity analysis should broaden its scope to include several areas that have witnessed important developments in the intervening years between 2002 and today:

- **Integrity: Preserve payment system legitimacy**

In the decade since passage of the USA PATRIOT Act, we have witnessed the expansive growth of obligations of the banking industry, and other financial services providers, to monitor for, detect, and report suspicious activity to combat use of the payment system for financial crimes from money-laundering to terrorism financing and beyond. Similarly, the financial sector bears the brunt of compliance with a range of sanction regimes. The government's expectations for committing industry resources to all these obligations must be accounted for as a necessary component of any new payment system. In fashioning such a system, we cannot afford to underestimate the operational challenges of these requirements or the expense that will be incurred in meeting them.

- **Regulatory Oversight: Protect fair market competition**

The acknowledged lesson learned from the past decade's financial crisis is that the risks of the non-bank financial sector can have a catastrophic impact on our economy. Financial reform has been intended to strengthen our regulated and supervised banking sector as the country's bulwark for surviving such risks. It would be folly indeed to let as important a market utility as a new payment system to be constructed in a way that would again generate non-bank financial risks to the detriment of our banking sector and ultimately, the broader economy. To the extent non-bank payment providers are subject to statutory or regulatory requirements to ensure that they have the financial resources to complete payments those requirements are more disparate and less reliable than the combination of regular capital examinations and deposit insurance that help to ensure the integrity of bank payments. Banks and non-banks providing payment services should be held to the same high standards.

- **Security: Cyber payments require commensurate cyber security**

Throughout history, security has been an essential element of any reliably functioning payment system. The increasing appreciation for the vulnerabilities of the economy across all sectors in the interconnected digital world we inhabit necessarily teaches us that security is a foundational prerequisite of establishing a future electronic payment system. This entails more than assuaging consumer perceptions of mistrust. It goes to the robustness of the underlying infrastructure of the electronic network across which UPNRT payments will take place and upon which the very stability of our entire economy depends.

In view of these additional observations on the gaps and opportunities facing responsible development of a future payment system, ABA would amend the "over-arching problem statement" summarized by the Consultation Paper to read as follows:

The challenge for the industry is to provide a payment system for the future that offers product choices that taken together deliver the valued attributes of legacy payment methods—

convenience, safety, security, integrity and universal reach at competitive market prices to the end user—with technology that enables new operational efficiencies and enhanced utility.

Desired Outcomes

ABA concurs with most of the identified “desired outcomes” listed in the Consultation Paper as necessary, but not sufficient, elements of a strategy to achieve a viable solution to the “over-arching problem statement.” Although the listed desired outcomes include a formal recognition of the importance of security to a payments system solution, ABA believes the supplemental observations it offers to the gap analysis warrant additional strategic elements to accomplish the ultimate solution to the challenges faced in achieving the sought after future payment system.

As ABA discusses the desired outcomes, we will include our position on relevant questions raised for comment in the section of the Paper entitled, Questions for the Public.

- 1. Key improvements for the future state of the payment system have been collectively identified and embraced by payment participants, and material progress has been made in implementing them.*

It is interesting to note that the overwhelming acceptance and reliance on legacy payment systems in the U.S. may be the greatest challenge to introducing new payment types because current products are already performing at a high level. Payers can achieve the individual goal of NRT settlement through wire payments, ubiquity through paper checks, and financial privacy through debit card networks.

As the Consultation Paper observes, “In a world where several other countries are moving to ubiquitous near-real-time retail payment systems, the U.S. payment system does not have this capability...[but] is moving in this direction incrementally through private sector initiatives.” While this is an accurate description of the current state of payments in the U.S., the situation elsewhere results from other countries imposing change through some sort of government mandate or influence and has involved a much smaller number of institutions.

The U.S. industry has been responding to market demands for improved payments through “private sector innovation” and not as a result of a government mandate. This should be recognized as an example of a free market where suppliers respond to customer demands. Inserting government mandates into a working free market system may not be the best or preferred approach to ensuring a sustainable future payment system. Unlike the government, free market suppliers have the financial incentive to move nimbly to meet consumer demands.

ABA believes that the best method for making the material progress that is the goal of this desired outcome is to pursue a two-track approach. Such an approach will bring immediate energy and resources to improve system preparedness for more significant market developments in the future when the capabilities and adoption of technological advances become clearer and offer pathways forward that may not be feasible now.

First, the industry should consider short term changes that would improve the quality of payments, even if they do not meet all of the targets outlined in the Desired Outcomes of the Consultation Paper. These interim goals could be incremental improvements made upon existing payment types. For example:

- The adoption of some form of same-day ACH settlement would improve the payment system. Although it is not likely the increase in speed would approach an UPNRT transaction, it seems likely that this improvement could be achieved sooner and with less expended revenues than the creation of a brand new payment system.
- The growth of P2P transactions has been rapid and would likely increase even faster if it were easier to conduct and settle transactions between parties that use different service providers. Establishing message standards to facilitate frictionless payments between service providers would expand the size of the network, increasing the value of P2P transactions to users. A central directory associating bank account numbers with email addresses and mobile phone numbers could serve as a clearing house for interoperable P2P transactions. Improvements in P2P interoperability would improve ubiquity and could lead to faster settlement times, an essential feature of the Federal Reserve Banks' goal of UPNRT transactions.
- An adjustment to the East Coast and West Coast 3 p.m. settlement cut off times would be valuable. Cutting off payments at 6:00 p.m. on the East Coast makes sense on the East Coast, but that means that payments conducted in the middle of the work day on the West Coast miss the deadline, ensuring that same day payments can't be made. Extending the cut off time to later in the evening could result in more "same day" payments with only a policy change. Technological and other resource issues may need to be considered prior to this shift.

These near term changes should be achievable within the next three years.

In this initial phase and in preparation for the second stage, the industry and the Federal Reserve Banks should continue to evaluate longer term options for creating a new payments infrastructure that would take the best aspects of the legacy systems and incorporate them in a market driven strategy for attaining the future payment system envisioned by desired outcomes 2 through 5.

The Consultation Paper projects a ten-year time line to implement fully a faster, better payment system. The Federal Reserve Banks appreciate that significant upgrades to existing systems or the creation of a new type of payment will require substantial commitments of resources and

venture capital by payment providers. These changes will take time to implement and to demonstrate their market viability.

Nevertheless, ABA believes that a ten-year time horizon is too long given the rapid changes in technology and accelerating use of mobile platforms for personal and business activity. As success in implementing the first stage provides lessons learned for handling new capacities, and as market demand is better articulated, strategies for successfully managing new venture risks and assuring system sustainability will be more apparent thereby creating the supportive business environment for new payment product adoption by providers and users. This will enable the time line to be accelerated. At such a point, ABA believes the market, not the government, will drive progress to achieve the optimal digital UPNRT functionality desired for the future payment system.

- 2. A ubiquitous electronic solution(s) for making retail payments exists that does not require the sender to know the bank account number of the recipient. Confirmation of good funds will be made at the initiation of the payment. The sender and receiver will receive timely notification that the payment has been made. Funds will be debited from the payer and made available in near real time to the payees.*

As the central recommendation in the Consultation Paper, this desired outcome describes the primary objective of providing a UPNRT payment option. ABA members of all sizes aspire to be active providers of such a new payment product. However, this new payment option will not exclude other payment choices from being offered in a competitive and evolving payments market. ABA believes that the future payment system is one that not only realizes the advancement of electronic UPNRT payments, but one that efficiently supports legacy payment products or other payment innovations that provide choice of features that match prices with user value.⁴

For example, if parties desired payments that are fast and maintained the privacy of financial data then a payment type could meet that need even if it were not ubiquitous. Similarly, when ubiquity and privacy are most important, P2P payments that settle overnight may meet consumer need. The industry should not let the perfect be the enemy of the good when it comes to offering the payment products just because not all of the “correct” boxes are checked. The future payment system will offer choices that deliver varied functional features whenever economically feasible and in keeping with customer needs and preferences.

⁴ The need and desirability of attributes of a particular system or transaction, e.g. speed and ubiquity, may depend on the size and type the transaction. There may be value in large dollar transactions not being as fast and ubiquitous as smaller dollar transactions in order to control for risk, fraud, errors, and payments made under duress, especially in an era of mobile phone ubiquity.

In addition to the characteristics of an electronic UPNRT product itself, it is necessary to deliver the product with controls and within a structure that addresses the other policy imperatives we have previously identified in the gap analysis:⁵

Maintain Integrity. Payments facilitate all forms of commerce, and as a result the overall stability, efficiency, and integrity of the payments system are of paramount importance. In short, the system must “always work.” This operational consistency, as well as the strength of its security against corruption and its compliance with applicable financial crime and sanctions controls, is encompassed within the imperative of integrity. All participating institutions—whether they are banks, payment networks, telecommunications companies, high tech firms and the like—must maintain necessary controls and be subject to sufficient government oversight to ensure that the integrity of the payments system is never in question. Moreover, payment system providers have become important government partners in enforcing various federal laws meant to combat illegal money laundering, threats to our nation’s cyber security, and other mandates.

Ensure Consumer Protections and Fair Competition. Federal law provides numerous protections for consumers when they make electronic payments such as protection against unauthorized charges and defined procedures for disputing charges. With this foundation in place, consumers have come to expect a high level of protection across all electronic payment types, regardless of the particular provider or product or a provider’s status as a bank or nonbank. Banks, retailers, networks and others have all made significant investments in the U.S. payments infrastructure. As these systems have grown and incorporated new technologies, the rules and standards governing them have evolved to accommodate these advances. A common sense of fairness argues that all participants, whether incumbents or new entrants, operate by a similar set of rules and standards, including enforcement and examination standards. This ensures that all participants have parallel financial incentives to innovate, and eliminates anomalies in the market driven solely by government policies that apply to some players but not others. As we have experienced in the recent crisis, unlevel regulatory playing fields ultimately erode customer protections as unsupervised non-bank competitors garner market share at the expense of vulnerable parties.

Preserve the Insured Depository Franchise. Banks have been the keystone of the American payments system and ABA members in particular have been leaders in its development and protection over the decades. It is no coincidence that the Federal Reserve System is celebrating its 100th anniversary and ABA has been assigning routing numbers for 102 years. (We have been partners in the Federal Reserve Banks’ clearinghouse functionality from the beginning.) Implementing a UPNRT product without direct transaction account access through banks of all charters and sizes would undermine the banking sector; diminish the resiliency of the American economy’s financial backbone; and impair the depositor protections that for the last 80 years have assured customers that their day-to-day liquidity, as well as their savings, will survive the loss of any one institution due to the strengths of a diverse and robust industry. Any new

⁵ ABA has recently addressed these elements in *The Changing Face of the Payments System: A Policymaker’s Guide to Important Issues*, <http://www.aba.com/Tools/Function/Payments/documents/2013EmergingPayments.pdf>

payment product with the compelling features of UPNRT must be implemented in a way that enables banks of all sizes to realize those functionalities for the benefit of their customers on competitive market terms. To proceed otherwise would threaten a disintermediation of insured deposits from banks serving communities across the country to the severe detriment of those local economies and the individuals who live there.

In summary, ABA members support, and will work actively to pursue, the achievement of desired outcome 2 as a major advance toward a modern payment system. It is an advance that must build on the strengths of the legacy system that has served our country well and has been delivered by a banking industry whose diversity is, and must remain, the foundation of our payments infrastructure for the future benefit of all persons and businesses in every community across our nation.

ABA believes that there may be multiple paths to achieving a UPNRT product or products in the array of payment options a future payment system will offer. In that spirit we welcome the Consultation Paper's interest in exploring such alternatives.⁶ However, ABA believes that the more fulsome discussion it deserves requires more consideration than the comment period on the Consultation Paper affords. We look forward to providing perspective on these issues over time and through continued engagement with the Federal Reserve System.

- 3. Over the long run, greater electronification and process improvements have reduced the average end-to-end (societal) costs of payment transactions and resulted in innovative payment services that deliver improved value to consumers, businesses, and governments.*

This desired outcome rightfully recognizes the benefits that payment process “electronification” has already delivered to our current payment system. As part of considering this value proposition the Consultation Paper questions the persistent levels of paper checks still present in the payment system. The discussion states that the Federal Reserve Banks believe that aggressive actions may be needed to accelerate the migration to electronic payments. While this may be true, it makes more sense to recognize that this “desired outcome” will only be achieved if the industry creates a faster, safer, more ubiquitous payment that *users* perceive is better than a paper check or cash. Volume will decrease as a natural by-product of having to compete with something better. Clearly, paper checks and cash remain attractive to payers and remain usable when there are electronic system failure and electrical outages: until a superior alternative is provided, they will continue to be used. Focusing on providing better payment options will address this situation.

While ABA acknowledges the benefits of electronification, it would be a mistake not to recognize that electronification also brings with it operational challenges in the form of new fraud typologies and the faster commission of legacy fraud. Faster settling NRT payments also

⁶ See Q6 of the Consultation Paper.

means faster NRT fraud. These challenges are not insurmountable, but they must be recognized and dealt with and not ignored in the headlong rush to embrace new technology.

4. *Consumers and businesses have better choice in making convenient, cost-effective, and timely cross-border payments from and to the United States.*

ABA concurs with this desired outcome. We recognize that the future American payment system must provide more than reliable domestic transactions. In this inter-connected global economy, our system must enable Americans to transact efficiently parties outside our borders.

It is important to recognize that cross-border payments fall into two groups, personal and commercial. Personal payments are generally smaller and are subject to Section 1073 of the Dodd-Frank Act that recently went into effect. As a result, consumers will be provided with detailed disclosures of fees and the timing of the payments, but the effect has been to make the process slower and more expensive and has even driven banks that have been providing this service out of the market entirely. Existing regulations will hobble technological improvements regarding consumer cross-border payments.

Commercial cross-border payments can be improved through the adoption of international standards and providing better remittance information with each payment. The adoption of ISO Standard 20022, the universal financial industry messaging scheme, would be a good step in improving the quality of international payments.

The Federal Reserve Banks have considerable influence globally. Leveraging this influence to drive change in jurisdictions outside its direct control would have a positive impact on advancing efficiency. Participation in initiatives with organizations such as the International Payments Framework Association (IPFA), the Society for Worldwide Interbank Financial Telecommunication (SWIFT) and others will allow the Federal Reserve Banks to promote standard processes to improve cross-border payment services. As an example, the proliferation of the International Bank Account Number (IBAN), expanding from the EU to over 90 countries, shows how efficient standards can be adopted outside of the geography of their original mandate.

As globalization continues, it becomes imperative that the message formats in use within the U.S. match those used outside this country. The maintenance of the structured process to monitor international message format development and to incorporate changes into the domestic formats will ensure end user satisfaction and encourage use of electronic payment methods, as well as guarantee the continued competitiveness of U.S. payments institutions. As the Federal Reserve Banks use influence for process standardization, the same may be applied to message formats, gradually encouraging the global industry to adopt a unified standard. As this will take some time, we recommend immediate focus on improving existing field mapping between domestic and international formats.

- 5. The Federal Reserve Banks have collaborated, as appropriate, with the industry to promote the security of the payment system from end-to-end amid a rapidly evolving technology and threat environment. In addition, public confidence in the security of the Federal Reserve Financial services has remained high.*

Given the significance that ABA has already discussed for payment system security, we certainly support this desired outcome. It follows that we urge the Federal Reserve Banks to continue to emphasize security as a high priority. The importance of protecting payments data will continue to grow as volume increases and more information accompanies the transactions. In addition to the volume of the payments and the associated information, the increased velocity of transactions makes security a concern. Just as a faster payment between friends is a desirable outcome, fraudsters will use faster payments to attempt to steal more money. Improvements in system security must move in lockstep with advances in payments volume and speed.

Role of the Federal Reserve Banks

The Federal Reserve Banks should continue their strong effort to improve the payment system through the role of facilitator and information exchange catalyst. The Federal Reserve Banks' actions with regard to the Consultation Paper, the annual Payments Symposium, and their ongoing outreach to the industry have provided an initial boost and an ongoing source of support to the discussion taking place across the industry. This is a valuable service that should continue.

One of the aspects that make discussions led by the Federal Reserve Banks attractive to the broader industry is that they carry no bias for or against a specific technology or product type. That neutrality is essential to building trust among parties who are also competitors. As a non-biased facilitator, the Federal Reserve Banks can help the industry find its own path.

The Federal Reserve Board has the primary role of regulating the American payment system as part of its express mission statement. This role is vital to assuring the payment system works for the benefit of the American economy. The Board must be given the authority necessary to regulate and supervise effectively all payment providers that participate in the American payment system.

The Federal Reserve Banks currently play an active role in the payment system through their ACH operations, check clearing, and Fedwire services. This operational role in the payments system is a significant component of the Federal Reserve System's express mission with regard to payments, as noted in the Fed's website celebration of its 100th anniversary. Whether the System has an operational role in the development of its own UPNRT option or some alternative option depends on whether the absence of such a capacity would undermine its mission. It is worth noting that it does not have a debit network operational capacity under our existing payment structure and yet no one suggests that the Federal Reserve has failed its payment responsibilities due to that omission.

ABA believes it is too soon to tell if there will be an appropriate operational role for the Federal Reserve Banks in any emerging payment product options. Today, ABA is confident that its insistence on the four essential attributes of a future payment system can be met by solutions driven by the private market if the regulatory structure is vigilant about enforcing a level playing field and is supported legislatively, if needed, with the necessary tools to cover non-bank competitors. Should this confidence not be borne out or should the diversity of banking industry participation in the provision of new payment options be threatened, fulfillment of the Federal Reserve's payment mission through a new operating role may be warranted.

Conclusion

ABA welcomes the Federal Reserve Banks' encouragement to improve the speed and efficiency of the U.S. payments system. Our members support developing innovations to the payment system that support ubiquity, faster settlements, and financial privacy, while not eliminating payment options that customers value and that can continue to be economically provided.

ABA appreciates the opportunity to comment on the Consultation Paper. We support the Federal Reserve Banks' efforts to inform the public policy debate with input from industry participants and we look forward to working with you as we move together to create a better, faster, safer payments system.