



December 13, 2013

**Re: Payment System Improvement – Public Consultation Paper**

Capital One Financial Corporation (“Capital One”)<sup>1</sup> appreciates the opportunity to submit a response to the Federal Reserve Banks’ “Payment System Improvement – Public Consultation Paper”<sup>2</sup> (the “Paper”) and supports the Federal Reserve’s efforts to open a dialogue about the evolution of the U.S. payment system to all participants and end users. We have provided input to and support the comments on the Paper favoring modernization and outlining concrete steps necessary to achieve that goal provided by several industry groups, including those of the American Bankers Association, SWACHA and The Clearing House. We are submitting this comment paper targeted to a few key issues and opportunities.

The U.S. payment system is a critical piece of the U.S. and global economy. As technology, regulation and other countries’ payment systems have evolved, however, there have been limited significant improvements to the U.S. payment system in the past thirty years. Failure of the U.S. payment system to progress quickly and establish an effective model for future innovation likely will result in greater disparity of offerings for end customers and less ubiquity, creating greater confusion of end customers and diminishing the United States’ role as a global leader in payments.

**A. The Role of the Federal Reserve Banks**

We believe that the Federal Reserve Banks should remain central to the strategy for the U.S. payment system, including the modernization of the system. The Federal Reserve Banks are in a unique and unbiased position to continue to take an active role in understanding and coordinating industry perspectives and activities, develop standards that apply to all payment systems participants and helping ensure parity across the different participants through thoughtful and deliberate interaction.

The Federal Reserve Banks also should play a coordinating role among the various U.S. regulators, and between U.S. and foreign regulators, and providing subject matter expertise on

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<sup>1</sup> Capital One Financial Corporation ([www.capitalone.com](http://www.capitalone.com)) is a financial holding company whose subsidiaries, which include Capital One, N.A., and Capital One Bank (USA), N. A., had \$206.9 billion in deposits and \$289.9 billion in total assets as of September 30, 2013. Headquartered in McLean, Virginia, Capital One offers a broad spectrum of financial products and services to consumers, small businesses and commercial clients through a variety of channels. Capital One, N.A. has more than 900 branch locations primarily in New York, New Jersey, Texas, Louisiana, Maryland, Virginia and the District of Columbia. A Fortune 500 company, Capital One trades on the New York Stock Exchange under the symbol “COF” and is included in the S&P 100 index.

<sup>2</sup> The Paper is available at [http://fedpaymentsimprovement.org/wp-content/uploads/2013/09/Payment\\_System\\_Improvement-Public\\_Consultation\\_Paper.pdf](http://fedpaymentsimprovement.org/wp-content/uploads/2013/09/Payment_System_Improvement-Public_Consultation_Paper.pdf).

regulatory and legislative matters concerning the U.S. payment system. Given the unique role of the Federal Reserve Banks, they can and should continue to serve as a trusted partner in these conversations.

We urge the Federal Reserve Banks to approach plans to improve the U.S. payment system with two broad objectives: (i) first, develop a holistic vision for the end-state of the system following any improvements; and (ii) second, create a plan setting out both specific major system improvements that can be implemented in the next three years and improvements that can be completed in subsequent years. We do not believe that the proposal in the Paper of a ten-year plan to make certain system improvements is the most effective way to approach this challenge. The Federal Reserve Banks should work with the industry to develop both the holistic vision for the end-state of the U.S. payment system and those improvements that can be completed in the short- and longer-term.

In order to best support and execute on the U.S. payment system strategy, we believe that the Federal Reserve Banks should consider potential inefficiencies in both the legacy districting model and the historical split focus of the wholesale and retail product lines. Arguably, this structure is no longer the most effective means of supporting needed changes.

## **B. Innovation and Evolution of the U.S. Payment System**

As the industry develops plans for modernizing the U.S. payment system, it is imperative that we follow certain guiding principles. To be successful any plan should:

- Protect and secure the customer's banking credentials<sup>3</sup>
- Address the needs of all participants while paying special attention to the use cases for consumers and small businesses
- Ensure that consumer protection capabilities and costs are built into new solutions
- Preserve existing revenue models while modernizing the payment system
- Ensure that new capabilities do not unintentionally transfer liability to parties who bear the greatest risk
- Focus on capabilities that give the customer greater control over the disbursement of their funds and reduce fraud
- Be deliberate about creating solutions that will replace checks and evaluate levers to decrease cash usage

We do not believe that any strategy for improving the U.S. payment system should be to build an entirely new payment system. Rather, any strategy should focus on evaluating the components that are missing in the current electronic payment systems and how those gaps can be closed. We believe this is a better option as payment system participants have developed robust

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<sup>3</sup> This will not only minimize fraud but will increase consumer confidence in these improved solutions.

capabilities and products around the current system components and can continue to provide those to their customers while developing new features as they become available.

Moreover, in looking at opportunities to modernize the U.S. payment system, the Federal Reserve Banks should evaluate and, where possible, seek to leverage and formalize existing networks and services, both public and private, to expedite the build-out of new capabilities.

While the Paper addresses a broad range of topics, this response focuses on three key opportunities:

### **1. Extending the National Settlement Service and FedWire settlement windows**

The National Settlement Service and FedWire currently are centered on the end of the business day for the East Coast (5:00 p.m. ET). Many financial institutions and companies located both on the East Coast and throughout the rest of the country, however, do not have their end of day until much later.

In the short term, to support the needs of the rest of the United States, the Federal Reserve Banks should consider extending their settlement services to match the end of business day for the West Coast. Over the long term, as the industry implements future capabilities, including speeding up settlement times for low-value payments, the National Settlement Service and FedWire settlement windows should match the needs of both batch and real-time settlement. This may include opening the service on weekends and some holidays.

### **2. Development of real-time messaging systems**

In order to support the concept of faster or near-real time payments, and preserve the features of the current payment systems, Capital One believes that developing a real-time messaging system, similar to SWIFT, would be beneficial for the U.S. payment system. Capital One envisions this service would enable payment system participants to send both transaction- and information-based messages in real-time or near-real time to other participants and would allow settlement to happen through either an intra-day batch process (*e.g.*, ACH) or real-time (*e.g.*, Wire). This approach would allow for the support of a bi-lateral, data-rich environment that enables more flexible and efficient innovation in the future while preserving the features of the current payment systems currently enjoyed in the United States.

### **3. Build out directory services that provide security to customer account numbers**

In today's environment, customer payment credentials are proliferated across multiple networks, providers and systems.<sup>4</sup> This creates greater risk for both the customer and payment system participants.

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<sup>4</sup> For example, payment credentials are included on paper checks exchanged between parties; supplied at time of purchase both online and in person; and provided to remit bill payments online directly to various parties.

We believe many of the use cases addressed in the Paper, including P2P, P2B and B2B payments, would benefit from the development of ubiquitous directory services that are managed by operators in the payment system. These types of services would provide greater connectivity between end users, increase electronification of payments and help to secure customer account numbers by providing an alternative way to push money to end users, rather than providing end users' routing transit and account numbers.

### **C. The Role of Financial Institutions and Payment Service Providers**

Because risks to the payment system can arise through any participants in the system, we believe that standards set forth by the Federal Reserve Banks and other U.S. regulators should apply and be enforced equally across *all* direct participants, regardless of charter or legal entity structure. Moreover, financial institutions should continue to play a critical role in accessing the payment system and safe-guarding the financial health of end customers. However, this does not mean that non-financial institution processors do not, and would not continue to, play an important role both in the evolution of the payment system and in providing services directly to end customers.

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Capital One is very supportive of the Federal Reserve Banks' efforts to develop a sustainable plan to modernize the U.S payment system. We believe the Paper represents a positive first step to open the dialogue among the Federal Reserve Banks, the various payment system participants, and end users. Capital One encourages the Federal Reserve Banks to continue the discussions between these parties and to establish ongoing forums to drive development of a sustainable plan.