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*Via Email: comment@FedPaymentsImprovement.org*

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RE: Federal Payment System Improvement Public Consultation Paper

To whom it may concern:

Commerce Bancshares, Inc. ("CBI") is a regional bank holding company with one bank subsidiary, Commerce Bank, ("Commerce"), and total assets of \$22.5 billion at September 30, 2013. Commerce is a full-service bank, with approximately 360 banking locations in Missouri, Illinois, Kansas, Oklahoma, and Colorado. A full line of banking services, including investment management and securities brokerage, is offered. CBI also has operating subsidiaries involved in mortgage banking, credit related insurance, and private equity activities.

### **General Comments/Observations**

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

### **Role of the Federal Reserve**

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

- **Catalyst** – By issuing the Public Consultation Paper and hosting various forums to discuss the gaps, opportunities and desired outcomes the Federal Reserve Banks are serving as a catalyst for changes and improvements in the payment system.
- **Leader** – After gathering input from the diverse population of respondents, the Federal Reserve Banks should formulate a position and must then lead the industry toward the desired outcome(s). The Federal Reserve Banks exhibited such leadership with respect to Check 21 and the industry moved to image exchange within a short period of time.
- **Operator** – There are actions the Federal Reserve can take in its role as an Operator that will move the industry toward a faster and more efficient U.S. payment system; support modification of the ACH system and/or offer a new near-real-time system.

## **Collaboration with Payments Infrastructure Participants**

The Federal Reserve should foster collaboration among other critical payments infrastructure participants, including NACHA and The Clearing House.

## **Define Near-Real-Time Payments**

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

## **Specific Question Responses**

### **Q1. Gaps & Opportunities**

Commerce is generally in agreement with the gaps and opportunities identified in the Public Consultation Paper. We feel that keeping regulated financial institutions, which have the trust of consumers and businesses, at the center of payments, is critical to achieving the vision of a ubiquitous, near-real-time payment system. Innovators will come and go, but financial institutions assure the safety and security of payments.

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

### **Q2. Desired Outcomes**

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

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

### **Q3. Role of the Federal Reserve Banks**

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

#### **Q4. Ubiquitous Near-Real-Time Payments**

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

#### **Q5. Features of a Near-Real-Time Payments System**

Commerce agrees with the features identified for a near-real-time payment system. What is missing from this list of features is the settlement component. The Federal Reserve Banks need to outline their vision for settlement.

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

- **Separate Wire Transfer-Like System** – The current wire transfer system provides good funds with immediate settlement and has a clear purpose. Creating a separate system with similar features would add another payment system which is not desirable, could create confusion among participants with respect to which system is most appropriate for their urgent payment needs and could impact revenue associated with wire transfers. Wires do not currently support end-to-end processing features, which is important for B2B payments. The positive aspect of this solution is that the Federal Reserve owns the domestic U.S. wire system, which could make evolving to a new wire transfer-like system more expedient. However, we feel the negatives outweigh this positive.
- **Linking Existing Limited-Participation Networks** – In theory this could be an attractive option; however, encouraging cooperation among proprietary systems could prove to be very challenging. We believe that negotiating common rules and a ubiquitous infrastructure could be nearly impossible. Also, many of these networks are operated by unregulated entities, which could disenfranchise regulated financial institutions.
- **Modifying the ACH** – The ACH is an existing ubiquitous network that can accommodate payment-related data, serves consumer and business payment needs and can support global payments. There are examples of faster processing and settlement of ACH-like systems around the globe, which suggests the U.S. ACH, could be modified to achieve the desired outcomes. If the ACH is to be modified, there will have to be rule changes and financial institutions may deem it appropriate to more fully integrate ACH into their DDA systems, which would be costly. The rule changes would have to serve the interests of all banks, not just the large banks. Recognizing these challenges, we believe that modifying the ACH is available option.
- **Enhancing Debit Card Networks** – Ubiquity, account masking, and for pin-based transactions, confirmation of good funds and near-real-time notification to the DDA, are attributes similar to the desired outcomes for near-real-time payments identified by the Federal Reserve Banks. However, these networks primarily support debits, with limited credit capability. Significant modifications would be necessary for this system to fully support the desired outcomes. Also, high per-transaction costs, fraud rates and related losses, coupled with the ownership/control structure of debit card networks makes this option unappealing.

- **Implementing an Entirely New Payment System** Commerce believes that an entirely new system is a viable option only if it is designed to replace one or more of the existing rails in the payment system. A core system with modules that support each of the existing payment types as well as near-real-time is ideal. This would also allow phased implementation and eventual retirement of systems supporting each of the rails.

#### **Q6.ii. Pros and Cons or Costs and Benefits**

Our thoughts regarding pros and cons of the various options are expressed above.

#### **Q6.iii. Interbank Settlement**

Near-real-time authorization and funds confirmation are essential. Commerce believes interbank settlement could occur at specified times throughout the day. This could be accomplished in batch-mode, which would be less expensive to implement than continuous flow settlement. Looking to the settlement scenarios of other countries could prove beneficial in determining the frequency of interbank settlement.

#### **Q6.iv. Payment Scenarios**

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

#### **Q7. Easier Check Payments/Fully Electronic Payment Orders**

We believe that efforts to improve check payments would take scarce resources away from developing near-real-time. There have been significant advances in the check world in the last decade that has improved speed while taking out costs. But, check payments continue to decline and the marginal benefit from further improvement would not justify the cost of those improvements. Efforts should be directed to building a new, faster, safer payment system to replace one or more existing rails.

#### **Q8. Near-Real-Time Payments Effect on Today's Fraud Issues**

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

#### **Q8.i. New Fraud Risks**

There will always be new fraud risks. Criminals and careless behavior create fraud risks, not payment systems.

#### **Q9. Pivotal Change to Mobile Payments**

Ubiquity and near-real-time payments will have a tremendous impact on mobile payments, particularly in the P2P and P2B space. Current systems are generally proprietary, requiring time-consuming or cumbersome registration/enrollment processes. The importance of mobile payments security must not be overlooked.

#### **Q10. Implications of No Action**

If the reference to "the industry" refers to financial institutions and supporting organizations, the implications of not taking action to implement faster payments is significant, and could result in financial institutions becoming disenfranchised. Others will find a way to support faster payments if financial institutions do not. There is consensus that faster payments are necessary; the question is not if, but how to implement. The sooner a clear path is determined, the sooner the industry will move in this direction.

#### **Q10.i. Costs**

The costs of not implementing faster payments are a decline in the customer base, fewer DDA accounts and a reduction in revenue.

#### **Q11. Modernize Core Processing/Backend Systems**

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

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

#### **Q12. Centralized Account Number/Routing Directory**

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

#### **Q13. Moving Away from Checks**

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

#### **Q14. B2B Payments/Consumer Bill Payments**

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

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

#### **Q15. Broader Adoption of the XML-based ISO 20022**

In view of the ever-expanding global economy broader adoption of the ISO 20022 message standard seems to make sense. If it can be validated that adopting the ISO 20022 would facilitate end-to-end electronic payments and processing for businesses in the U.S. and abroad, this becomes a strategic priority.

#### **Q16. Strategies & Tactics for Consumers & Businesses to have Greater Choice in Making Cross-Border Payments**

Commerce believes for the industry to fully embrace convenient, cost effective, and timely cross-border payments for consumers and businesses, the industry will need to: (1)Limit costly regulatory and network rule changes currently driving up product costs and causing some financial institution to exit international services for consumers and businesses completely; (2)Increase the number of countries (end-points) who have the capability to exchange payments through the Fed Global Service or a similarly priced service; (3)Provide clarity of the specific authorization rules/requirements by destination country; and (4)Broader education to consumers and businesses on cross-border payment options available within the U.S. payments industry.

#### **Q17. Payment Security**

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

##### **Q.17.i. Key Threats**

Cyber-attacks, account takeover and careless behavior are key threats today and will remain. The reality is that threats evolve faster than the security to mitigate the threats. Faster payments will increase the speed at which payments can be moved, thus increasing the risks.

##### **Q17.ii. Threats Not Adequately Addressed**

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

##### **Q17.iii. Operational/Technology Changes to Mitigate Cyber Threats**

End-to-end encryption and stronger authentication, i.e. biometrics, could be implemented to further mitigate cyber threats. Security professionals will undoubtedly contribute meaningful suggestions to this question.

### **Q18. Information on Threat Awareness and Incident Response Activities**

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

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

#### **Q18.i. Available Information**

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

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

### **Q19. Future Payment Standards to Improve Payment Security**

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

#### **Q19.i. Obstacles**

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

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

### **Q20. Fed's Role to Promote End-To-End Payment Systems Security**

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

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

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

**Q21. Additional Perspectives on U.S. Payment Systems Improvements**

We applaud the Federal Reserve Banks for encouraging this dialogue. The next step must be a clear roadmap to achieving the desired outcomes. Once this roadmap is developed, the Federal Reserve Banks must take a leadership role to assure these outcomes are achieved.

Thank you for the opportunity to provide comments about the payment system improvements. If you have any questions regarding our comments, please feel free to contact either of us.

Sincerely,

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